

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

JOINT APPENDIX

UNITED STATES COURT OF APPEALS

DISTRICT OF COLUMBIA CIRCUIT.

MILTON J. SHUCK, doing business as
M. J. SHUCK COMPANY,
Petitioner,

—v.—

SECURITIES AND EXCHANGE
COMMISSION,
Respondent.

No. 14208

311

PETITION TO REVIEW ORDER OF SECURITIES AND EXCHANGE COMMISSION

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*United States Court of Appeals
For the
District of Columbia Circuit*

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Joseph W. Stewart

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UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

JANUARY TERM, 1958

MILTON J. SHUCK, doing business as
M. J. SHUCK COMPANY,
Petitioner,

—v.—

SECURITIES AND EXCHANGE
COMMISSION,
Respondent.

No. 14,208

Before: PRETTYMAN, *Circuit Judge*.

ORDER

Counsel for petitioner and respondent having appeared before me at a prehearing conference and having submitted a prehearing stipulation regarding the issues and filing of further pleadings, it is

ORDERED, that the aforesaid stipulation be approved and that the Clerk be, and he is hereby, directed to file the stipulation forthwith.

IT IS FURTHER ORDERED that the prehearing stipulation be printed in the joint appendix and shall control further proceedings in this case unless modified by further order of this Court.

Dated: January 29, 1958.

**STIPULATION FOR PREHEARING CONFERENCE
IN THE**

**UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

MILTON J. SHUCK,
Petitioner,

—v.—

**SECURITIES AND EXCHANGE
COMMISSION,**
Respondent.

No. 14,208

It is hereby stipulated and agreed between Herbert J. Jacobi, Milton Pollack and Francis E. Koch, Attorneys for the Petitioner, and Thomas G. Meeker, Ellwood L. Englander and George Michaely, Attorneys for the Respondent, subject to the approval of the Court as follows:

I. The issues in this proceeding are as follows:

[The listing of issues is omitted here, since it was printed in full in Petitioner's Brief, pp. i-ii.]

II. The time for filing briefs and the joint appendix are as follows:

1. Petitioner shall file and serve his typewritten brief on or before February 24, 1958.

2. The respondent shall file and serve its typewritten brief on or before March 26, 1958.

Stipulation For Prehearing Conference

3. Petitioner may file and serve a typewritten reply brief on or before April 25, 1958.

4. The necessary number of printed briefs will be filed and served in each of the above instances, 20 days after each of the above dates.

5. The petitioner shall file and serve the printed joint appendix on or before May 8, 1958.

III. The parties contemplate that after the preparation of their briefs they may be able to reduce the size of the record by further agreements or stipulations.

/s/ FRANCIS E. KOCH,
Attorney for Petitioner.

/s/ ELLWOOD L. ENGLANDER,
Attorney for Respondent.

TRANSCRIPTS OF HEARINGS
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

IN THE MATTER

—of—

MILTON J. SHUCK, doing business as
M. J. SHUCK Co.,
39 Broadway,
New York, N. Y.

Code No. N. Y.
2914

Securities & Exchange Commission,
225 Broadway,
New York, N. Y.,
Monday, January 14, 1957.

The above-entitled matter came on for hearing, pursuant to notice, at 10:45 a.m.

Before: JAMES G. EWELL, *Hearing Examiner*.

APPEARANCES:

MILTON POLLACK, ESQ.,
111 Broadway,
New York, N. Y., and
EDMOND G. BLUMNER, ESQ.,
63 Wall Street,
New York, N. Y.

JOHN J. DEVANEY, ESQ.,
Chief of Enforcement Section, New York Regional
Office, Securities and Exchange Commission.

EILEEN E. EVERS,
Attorney, appearing on behalf of the Securities and
Exchange Commission.

*Transcript of Hearings
Joseph Barton—for Commission—Direct*

[16]

* * * * *

JOSEPH BARTON, called as a witness, having been first duly sworn, testified as follows:

Hearing Examiner Ewell: Your name, please.

The Witness: Joseph Barton, 110 Marine Avenue, Brooklyn, New York.

Direct examination by Miss Evers:

Q. Where are you employed? A. In the New York Regional Office of the Securities & Exchange Commission, 225 Broadway.

Q. How long have you been so employed? A. I have been employed by the Securities Commission for approximately 8 years.

Q. Could you tell us your duties. A. I am securities investigator.

Q. And you have been for 8 years? A. That is true.

Q. In the course of your official duties with the Commission did you investigate the books and records of M. J. Shuck doing business as M. J. Shuck Company? A. Yes, I did pursuant to an assignment I visited the Shuck firm on August 23, 1956 and obtained copy of their trial balances per their books as of August 22, 1956.

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Miss Evers: Mr. Examiner, I offer in evidence the trial balance of the general ledger of Milton J. Shuck as of August 22, 1956.

Mr. Pollack: May I see it. May I inquire preliminary, is this in your handwriting?

The Witness: Yes, It is.

Mr. Pollack: You took this information from something else?

Transcript of Hearings
Joseph Barton—for Commission—Direct

The Witness: From the general ledger of M. J. Shuck.

* * * * *

[18]

The Witness: I don't think I said I got it from the firm. I copied this from their general ledger.

Hearing Examiner Ewell: You made it up from the information on the books?

The Witness: That is right.

* * * * *

Mr. Pollack: Subject only to checking the accuracy of the copying process, I have no objection to the entry of the paper.

Hearing Examiner Ewell: I will receive it.

Mr. Pollack: I won't take the time of the Examiner at this point to examine into whether there is a mechanical error in this thing or not.

[19]

(Whereupon, document above referred to was marked Division Exhibit 1 in evidence.)

A. My analysis of that trial balance disclosed that the capital position of the Shuck firm, pursuant to Rule 15C31 showed a deficiency of \$71,820.40.

Q. How long had this been so? A. I can only talk as of August 22. I don't know how long it continued, but this was the condition as of August 22.

Miss Evers: Your Honor, I offer in evidence an analysis of the trial balance of M. J. Shuck Company and Milton J. Shuck as of August 22, 1956 as the Division's Exhibit No. 2.

Hearing Examiner Ewell: I understood you to

Transcript of Hearings
Joseph Barton—for Commission—Direct

say that the net capital deficit, pursuant to the Commission's Rule 15C3-1, amounted to \$71,820?

The Witness: Not the deficit. It is the deficiency, the deficit plus the amount required makes up the deficiency.

Hearing Examiner Ewell: In other words, to bring them in compliance with the rule, they would require that much?

The Witness: That's correct.

* * * * *

[20-22]

An analysis of the trial balance of M. J. Shuck Co. as of August 22, 1956 was received in evidence as Exhibit 2, subject to check for accuracy.

An extract of the customer's trial balance of M. J. Shuck Co. as of August 22, 1956 was received in evidence as Exhibit 3 subject to check for accuracy.

* * * * *

[24]

Miss Evers: Mr. Examiner, I offer in evidence an extract of the unsecured customers' balances of the company of Milton J. Shuck, doing business as Milton J. Shuck, as of August 22, 1956 as Commission's Exhibit 4.

Mr. Pollack: This is your statement, you took this off as carefully as you could and that the names and amounts shown on here are to the best of your knowledge accurate?

[25]

The Witness: The names and the amounts of the debit balances are from the books of Shuck. The compilation of the value of the securities and the amount of unsecured is my own compilation.

Transcript of Hearings
Joseph Barton—for Commission—Direct

Mr. Pollack: You made a compilation of the market value of the securities belonging to the customers?

The Witness: That is true in those individual accounts.

Mr. Pollack: As of what date did you value those securities?

The Witness: August 22.

Mr. Pollack: As of the close of August 22, 1956?

The Witness: That is right.

Mr. Pollack: You took the closing price and put down the extensions of the total values of the securities in the customers' accounts as shown on this paper?

The Witness: I did not use the closing price since these securities aren't listed and you use the pink sheet and I gave them the high bid for the value of their stock.

Mr. Pollack: In other words, you gave them the high bid, but you did not give them any part of the low asked?

The Witness: No, no part of that.

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Mr. Pollack: Subject to verification, I have no objection.

Hearing Examiner Ewell: What was the total amount of those?

The Witness: That only shows an unsecured of \$721.12.

It is just to tie in with the figure not on Shuck's book, on my analysis sheet to show you how I arrived at something that is not found in the general ledger of the Shuck books and records.

Mr. Pollack: If you had taken a figure inter-

*Transcript of Hearings
Joseph Barton—for Commission—Direct*

mediate of the high bid and the low asked, the \$700 would have been completely wiped out, isn't that so?

The Witness: In unlisted securities, stock that is offered doesn't constitute a market. It is how much they are bidding for the stock.

Mr. Pollack: I understand, but I say if you had taken a price intermediate, the highest bid and the lowest asked, the \$700 would have been more than wiped out.

The Witness: I don't know.

Mr. Pollack: Do you have an analysis of the prices that you did take?

The Witness: Yes.

Mr. Pollack: Would you offer that together with

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the exhibit.

The Witness: It is contained in Exhibit 3 showing the price of the stock and the stock in the particular account.

* * * * *

Hearing Examiner Ewell: All right, I will receive it.

(Whereupon, document above referred to was marked Division's Exhibit 4 in evidence.)

Hearing Officer Ewell: Proceed.

The Witness: This is a make-up of the fail to receive account with a balance as of August 22 totaling \$271,253.75 showing how much of those fails are firm

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account fails and the balance customers' accounts fails.

Mr. Moran: Would you describe for the record how you prepared that, Mr. Barton?

Transcript of Hearings
Joseph Barton—for Commission—Cross

The Witness: I took an itemization of the fail to receive account and then compared it with the firm's security position and if a stock showed up in failed to receive that was also long in the firm trading account, I ascertained when that fail started and if it was a date subsequent to the firm's position account, I said it was a firm fail and excluded it from aggregate indebtedness pursuant to the rule. This is only to arrive at an aggregate indebtedness figure.

Mr. Moran: The figures contained in the document you hold in your hand were taken from the books and records of Shuck & Company?

The Witness: That is true.

Mr. Moran: There are no figures of your own in there, any extensions of your own of any kind?

The Witness: No figures of my own.

Mr. Pollack: But the figures are characterizations of yours?

The Witness: That is correct.

Mr. Pollack: No objection subject to check.

[29]

(Whereupon, document above referred to was marked Division's Exhibit No. 5 in evidence.)

* * * * *

[31]

Cross-examination by Mr. Pollack:

[32]

* * * * *

Q. Did you after August 23, 1956 make any examination of the finances, books and accounts of the Shuck Company at any time? A. Not in their office, no, I did not.

Q. Was your visit on August 23, 1956, the only time that you ever visited the Shuck office? A. That's right.

Transcript of Hearings
Joseph Barton—for Commission—Cross

Q. Did you make an analysis of the position of the Shuck Company as of August 30, 1956? A. No, I did not.

Q. Are you able to tell the Trial Examiner whether or not on August 30, 1956, the Shuck Company had an excess of capital over the requirements of the Securities & Exchange Commission? A. If I examined the papers of someone else, I might be able to state what is on them.

[33]

Q. From your own knowledge and investigation up to the moment of this cross-examination, are you able to give us the answer to my question? A. Not from my own knowledge. I would have to look at papers.

[34]

* * * * *

Q. Were you informed in the course of your official capacity that a substantial capital contribution was put in to this firm during the latter part of August 1956? A. Yes.

Q. Were you informed in the course of your official duties that that substantial capital contribution corrected and achieved a correction of the capital deficiency that you noted in your testimony? A. Yes.

Q. Did you write any letters to the Shuck Company? A. No, I did not.

Q. Do you know of any writing issued by the Commission or its staff calling the attention of the Shuck Company to the facts that you have outlined? A. No, I don't know if we wrote a letter to the Shuck firm.

Q. Isn't it the fact that prior to this proceeding there was no written notice of the facts to the registrant that you elicited as a result of your investigation? A. I don't know, since I don't write the letters.

Q. You did not write any letter? A. No, I did not.

*Transcript of Hearings
Joseph Barton—for Commission—Cross*

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Q. You have no knowledge that any writing was communicated to the Shuck Company? A. No, I have not.

Q. Do you know of any written opportunity that was afforded to the Shuck Company to correct the situation that you noted when you made your inquiry on August 23, 1956? A. No, I do not.

Q. You didn't give them any written opportunity? A. I did not.

Q. You did not even communicate to them the results of your inquiry, did you? A. I think orally we may have had the accountant for the firm visit our office and was made aware of the financial position.

* * * * *

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Q. I will ask the question again and maybe in simpler form. Do you know of your own personal individual knowledge the answer to this question and the question: Was a written notice of deficiency given to the Shuck firm with an opportunity to correct that deficiency? A. Not by me.

Q. And you know of no such written opportunity? A. I do not.

Q. You testified with respect to Exhibit 4 that, which is entitled "Unsecured Customers' Balances" there was an unsecured position of \$721.12? A. That is right.

Q. You made that calculation on the basis of your evaluation at bid prices of the securities in the customers' accounts, is that right? A. At the high bid prices.

Q. Are you able to tell the examiner whether if you had taken a point, at any point between the bid price and the low asked price, whether that \$721.12 would have been completely wiped out? A. It wouldn't have been completely wiped out

*Transcript of Hearings
Joseph Barton—for Commission—Cross*

[37]

since two accounts have no securities in them amounting to \$124 so that can not be wiped out.

Q. Let's find out; here is an account of Mr. Kane, which showed a debit balance of \$9,000 and you have him listed for securities worth \$8,812.50. What securities were they?

A. That is Corpus Christi, 700 shares.

Q. What was the asked price of Corpus Christi on August 22, 1956? A. What was the bid and what was the high bid and what was the asked. There are several prices for Corpus Christi.

Q. You may answer any question you would like, but I would like to know what the asked price was also. A. The stock ranges from 3 to 3-3/8.

Hearing Examiner Ewell: That is the asked?

The Witness: That is the asked price.

Hearing Examiner Ewell: What was the bid?

The Witness: I gave them the high bid of 2-15/16.

Q. And there was a spread between 2-15/16's and 3-3/8 in those 700 shares of stock, is that right? A. That's right.

Q. Assume that you take the mid-point on that spread, that would amount to how many 16's? A. From 15/16's to 6/16's; that would be 7/16's.

Q. Suppose you took 3/60 of 700 shares, how much would

[38]

that amount to in dollars? A. Approximately \$42.

Q. So that the deficiency that you have down here of unsecured at the bid price of \$187.50, if you had adopted my method, would have been reduced by \$42 roughly? A. Yes.

Q. And that would be the situation roughly up and down

*Transcript of Hearings
Joseph Barton—for Commission—Redirect*

the line, wouldn't it? A. Whether it would be \$42 or whether there would be any reduction, I couldn't tell you.

Q. Let's take another test. Mr. A. Bolton had a debit balance of \$5,875 and you have him scheduled with securities valued at \$5,750. What securities were they? A. That is 500 Green Bay Mining.

Q. The 500 Green Bay Mining you valued at what price? A. 11-1/2.

Q. That was the bid price? A. That was the high bid.

Q. What was the asked price? A. The high asked was 11-3/4.

Q. So that there was a spread there only of a quarter of a point? A. That is right.

Q. And using my method, you could only adopt an eighth or some \$60? A. Yes.

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Q. So that the \$125 would be cut in half? A. According to your method.

Q. Will you agree, so that we don't have to go through all of them, that if my method were employed, this \$721 deficiency would be reduced? A. It would be reduced.

Mr. Pollack: Thank you.

Redirect examination by Mr. Moran:

Q. Mr. Barton, would you, if you haven't already stated, and I came in the room a little late, would you explain to the Examiner why you used the bid price and not the method or some method similar to what has been suggested by counsel? A. Because my method would be the more accurate method since what the stock is being bid is what the customer wants to pay, that is more true indication than counsel's method of taking it in between, between asked and bid. I can ask anything for the stock.

Transcript of Hearings
Joseph Barton—for Commission—Redirect

Q. In other words, is it correct to state that what you were doing is finding out what the indications were in the marketplace of what the people were willing to pay for the security on that particular day as a test of what value weighting you should give these securities, is that correct? A. That

[40]

is correct.

Hearing Examiner Ewell: I thought that the definition of market value was what a willing buyer and a willing seller would be willing to pay.

Mr. Moran: The bid price would indicate they are what the willing seller was willing to pay for the securities on that particular day.

Hearing Examiner Ewell: You mean the willing buyer.

Mr. Moran: Yes, sir.

Hearing Examiner Ewell: He did not take into account what the willing seller wanted to pay.

The Witness: If you were trying to value your securities, you wouldn't be interested in what a seller was interested in getting, you would be interested in getting what someone would buy your securities for.

Mr. Pollack: May I ask another question.

Mr. Moran: Certainly.

Hearing Examiner Ewell: I think the question of whether or not you are talking about market value as it is usually defined.

Mr. Pollack: I don't think the case turns on anything of that kind.

*Transcript of Hearings
Joseph Barton—for Commission—Recross*

[41]

Recross-examination by Mr. Pollack:

Q. May I ask you this, do you know that the M. J. Shuck Company is out of business? A. I had heard that they were out of business.

* * * * *

Q. You do know that from the end of August 1956 and thereafter, according to the information that reached you, there was an excess of capital over the requirements of the Commission in the Shuck Company. I think you testified to that a few minutes ago, is that right? A. That is true, from August 30 is the date you are talking of.

Mr. Pollack: Yes. That is all. Thank you.

* * * * *

[42]

Hearing Examiner Ewell: The notice of withdrawal according to the Commission's order, was filed October 24, 1956, is that correct?

Mr. Pollack: My copy of the letter is dated October 19, 1956, Mr. Examiner, and I can not explain the hiatus of the five days. All I have here is the letter that did go out. One copy to the New York office and the original to the Washington office.

* * * * *

[58]

The preliminary injunction issued by Judge McGohey in United States v. Shuck, S. D. N. Y., Civ. No. 112-267, Sep. 7, 1956, was admitted over objection as Exhibit 6.

* * * * *

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The summons, complaint, answer, affidavits, and memoranda submitted to Judge Mc Gohey in United States v. Shuck,

Transcript of Hearings
Colloquy

S. D. N. Y., Civ. No. 112-267, and the memorandum opinion of Judge Mc Gohey dated Sep. 6, 1956, were admitted as Exhibit 7.

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* * * * *

Mr. Moran: Yes. Counsel maintained that certain documents had been submitted to the Commission from time to time which he characterized as reflecting that the firm in question was in compliance with the rule. I wish now to correct the record in so far as I may have made a misstatement and state that this office of the Securities & Exchange Commission did receive from time to time various balance sheets from M. J. Shuck & Company.

* * * * *

Mr. Barton: Commencing September 14 and concluded on November 16.

Mr. Moran: On a weekly basis, Mr. Barton?

Mr. Barton: On a weekly basis.

Mr. Moran: Now that I have corrected the record in that sense, sir, I still maintain my position previously made that while notwithstanding the fact that we have received these documents from him, M. J.

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Shuck & Company, as far as I am concerned, they are self-serving declarations and do not, in my opinion, come within the ambit or over-all purview of the purpose of this hearing, which, as I understand it, control the period from August 22, 1956 to approximately September 6, 1956. It is the charge that the registrant in effect was in violation of Rule X15C31.

Transcript of Hearings
Colloquy

[64]

Hearing Examiner Ewell: From August 22?

Mr. Moran: August 22, 1956 to September 6, 1956 is the period set forth in the order.

Mr. Pollack: Mr. Moran is correct about that.

Hearing Examiner Ewell: Let me get this clear. Did you have a weekly report covering that period?

Mr. Moran: No, sir, we do not.

Mr. Barton: No submitted weekly report.

Hearing Examiner Ewell: But you had these weekly reports after September 6?

Mr. Moran: Yes, sir.

Mr. Pollack: Did you, Mr. Moran, actually have the books of the Shuck Company? Didn't you have the books under your own office under subpoena and use them to your heart's content up here?

Mr. Barton: No, a visit was made to the firm. We did not take the books here.

Mr. Pollack: You had the books, isn't that right?

[65]

Mr. Moran: I believe that the books and records were under subpoena, but I am advised by my colleagues that the purposes of having the books, which arose out of the subpoena being served, were for purposes other than determining whether or not the firm was in compliance with X15C31.

Mr. Pollack: You weren't barred for any purpose you had in mind while you had the books by Shuck were you?

Mr. Moran: I am advised by my colleague in an off-the-record discussion that the books were subpoenaed on or about August 22, 1956. As those books

Transcript of Hearings
Colloquy

were subpoenaed and remained in our possession for any period of time, I don't think that the books would reflect anything more current than August 22, 1956 and accordingly I am not in a position to agree that there was compliance with the net capital requirements any time during the period August 22, 1956 to September 7, 1956.

Mr. Pollack: Mr. Moran, as the Regional Administrator, are you in a position to inform the Trial Examiner whether anybody from the Commission went to the office of Shuck between August 22 and September 6 for the purpose of informing himself as to the then current position of Shuck ?

[66]

Mr. Moran: I will answer that question first by correcting my title, I am not the Regional Administrator, I am the Assistant Regional Administrator. I am advised that one of my associates did go to the Shuck firm on or about August 31, 1956.

Mr. Pollack: Will you also be frank and fair enough to state to the Trial Examiner to state that at that time it was reported back to you officially in your capacity as the Assistant Regional Administrator that the firm had an excess of capital over the SEC requirements?

Mr. Moran: I will be frank and state that in my position as Assistant Regional Administrator that information was not reported back to me, but I will not say that it was not reported back to that person's superior.

Mr. Pollack: Was it reported to you that over \$40,000 in cash was put into the capital of Shuck at that time?

Transcript of Hearings
Colloquy

Mr. Moran: I think we could shorten this thing by actually putting on the stand the man who can tell us what he found.

Mr. Pollack: I think you could shorten it by just a quick concession.

Mr. Moran: I would like to shorten it, but he will be in a position to tell us about this and there is a serious dispute as to whether or not they can be con-

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sidered contributions to capital and therefore the firm was in compliance.

Mr. Pollack: One other question, may we have it perfectly clear for the record in your official capacity as Assistant Regional Administrator that at no time on or after August 22, 1956 was a written notice given to Shuck of non-compliance with an opportunity in that notice to achieve compliance at any specified or unspecified time? I am referring only to a written notice from the Commission of capital deficiency.

Mr. Moran: I can only answer that question by stating that if we have an appropriate recess, I will undertake to search the file and determine whether or not any such written communication was sent to Shuck and if it was not sent, I will be happy to so state.

Hearing Examiner Ewell: I assume your question is directed at the provisions of the Administrative Procedure Act?

Mr. Pollack: Yes. I think we should have the recess now.

* * * * *

Transcript of Hearings
Colloquy

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Mr. Moran: Mr. Examiner, I would like—I don't know what time it is at the moment, but is it possible for us to adjourn until tomorrow morning because what counsel has raised now, I wouldn't claim would come as a matter of surprise, it comes as a matter of surprise to me——

Mr. Pollack: You don't claim that the Administrative Procedure Act is a surprise to you?

[69]

Mr. Moran: No, just the subject of whether a written notice was given.

Mr. Pollack: You mean, Mr. Moran, you weren't prepared to prove either the lack or the existence of it.

Mr. Moran: What we are prepared to prove you will be quite surprised and shocked, on all counts.

Mr. Pollack: I have never had a more able and genial adversary, Mr. Examiner.

* * * * *

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Mr. Moran: Mr. Examiner, before the Staff goes forward with the remainder of its case, I believe at the time of the adjournment last evening I had undertaken to make a search of the records of the office to determine whether or not any written notice with respect to a violation of 15-B (3) (1) had been sent by this office to M. J. Shuck & Company.

* * * * *

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Mr. Moran: I hereby stipulate on behalf of the Staff that no written notice was given to Milton

*Transcript of Hearings
Colloquy*

J. Shuck doing business as M. J. Shuck & Co., with respect to a violation of Rule X15-C (3) (1) for the periods mentioned in the Commission's order.

Mr. Pollack: Will you also stipulate for the same period of time, Mr. Moran, that no written notice of opportunity to comply was furnished to M. J. Shuck, again with respect to the same period?

* * * * *

Mr. Moran: I will stipulate that no letter from this office was sent to Mr. Shuck or M. J. Shuck & Co. pointing out these violations of law.

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Mr. Pollack: Will you stipulate that no other office of the Commission furnished any written notice or written opportunity to comply for the period beginning August 22, 1956?

Mr. Moran: I have to stick with the stipulation which I have offered because I have not examined any other records of the Commission in Washington or any other place.

Mr. Pollack: At this time you don't claim that any other office issued such a writing?

Mr. Moran: I don't so claim.

When I stipulate, you remember that I am stipulating only to the fact that no letter or written communication from this office was sent to them.

Hearing Examiner Ewell: No letter or other written communication?

Mr. Moran: That is right, by this office.

Mr. Pollak: What is there that you are reserving in that last statement, Mr. Moran, so that we have it out on the table?

Mr. Moran: I am only reserving this, counsel, that Mr. Shuck was advised in writing upon the receipt

Transcript of Hearings
Bernard D. Pollikoff—for Commission—Direct

of a summons and complaint of these violations of law which is and could be construed as a written notice. Now, whether it is a written notice coming within the purview of what you have in mind, I

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don't know.

Mr. Pollack: But except for that summons and complaint, you make no claim to any other written notice of opportunity to comply?

Mr. Moran: From this office, correct.

Mr. Pollack: According to the practice of the Commission with which you are familiar, such a notice would issue from this office in view of the fact that the man is engaged in business in this district?

Mr. Moran: Under ordinary circumstances that would be correct, sir.

BERNARD D. POLLIKOFF, called as a witness, and being first duly sworn, testified as follows:

Hearing Examiner Ewell: Your full name, sir?

The Witness: Bernard D. Pollikoff.

Direct examination by Miss Evers:

Q. What is your address? A. 200-22 46th Avenue, Bay-side, New York.

Q. What is your occupation? A. I am a securities investigator at the New York Regional Office of the Securities and Exchange Commission, and have been so since July, 1944.

Q. In the course of your official duties with the Securities and Exchange Commission, did you visit the offices

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of Milton J. Shuck, doing business as M. J. Shuck & Company? A. I did on August 31, 1956.

Q. Did you investigate the books and records of the company at that time? A. Yes. I examined their books and records and extracted therefrom a trial balance as of August 30, 1956, which I analyzed.

Q. Could you tell us about your analysis? A. Yes. Based upon my analysis, accepting all the entries on their books at their face value, the firm's capital position as of August 30, 1956 reflected an adjusted net capital of approximately \$3,000 more than was required on its aggregate indebtedness. However, there were several items of a questionable nature which if considered other than the manner in which they appeared on the books would have resulted in a capital position which was not in compliance with the Commission's rule.

Q. Could you tell us about these items? A. One of the items related to a profit of \$23,000-odd resulting from short sales on August 21st of 22,700 shares of Midrim Mining Company which were repurchased primarily on the same date.

Some of the shares were repurchased on the following date, August 22nd. These shares, I understand, were listed on the Toronto Stock Exchange, and the transactions made by Shuck

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were through a firm by the name of Stahl, Mills & Company, Ltd.

The confirmations of those transactions sent by that firm to Shuck indicated that these particular trades were effected in the over-the-counter market in Canada.

By their very nature they indicated an unusual profit on a transaction which in effect was a margin trade, not a cash

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trade, having been short sales and then repurchases without any margin or anything else having been deposited with Stahl, Mills, to my knowledge. At least the books didn't reflect anything like that.

Q. This is not the usual practice? A. It appeared to me to be an unusual transaction.

Other than that, I could then obtain no further information with respect to that particular trade.

Q. Did you request further information concerning those trades? A. At that time I did not. I only requested the confirmations of the transactions. The other items which raised some questions were deposits. On August 29, 1956, there was one of \$40,300 to Mr. Shuck's capital account, and there were no——

Mr. Pollack: What was the amount of the deposit?

The Witness: \$40,300.

There were no details on the books indicating what that consisted of. I then interviewed Mr. Shuck in

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his office to get some information regarding those particular entries. He told me that they comprised two checks of \$20,000 each and some small checks totaling \$300; and one of the \$20,000 checks represented a check drawn by a man by the name of Barrison. I asked Mr. Shuck what that represented and he told me that he had made a deal with Mr. Barrison under which Mr. Barrison was to receive the income on certain oil properties which Mr. Shuck claimed he owned, but which did not appear on his books.

I also asked him whether he had made any kind of an assignment to Mr. Barrison in connection with that income and he said that he hadn't. I also asked

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him whether he had executed any kind of an agreement with Mr. Barrison in connection with that item and he said he hadn't but he understood that his attorney was then drafting one.

Under the circumstances it was impossible for me to determine whether or not that represented money which was rightfully part of Mr. Shuck's capital or whether in fact it might not represent a loan or borrowing from Mr. Barrison which in turn would have represented a liability rather than part of his capital.

Q. Then there was nothing in writing to support this entry in the books? A. There was just merely a credit on the blotter

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which represented the bank deposit and the credit on the blotter was a posting into the capital account.

Q. And there was no previous showing in any way of Mr. Shuck's ownership of these oil stocks? A. His books didn't reflect any ownership of any oil properties.

Hearing Examiner Ewell: Did he claim that he sold any of his rights?

The Witness: He didn't claim that he sold his rights. He claimed that he had made a deal whereby Mr. Barrison was to receive the income on certain oil properties which he claimed he owned.

Hearing Examiner Ewell: Didn't you ask him whether it was a sale or a loan?

The Witness: Yes, I did, and he told me it wasn't a sale, that it was merely an arrangement whereby Mr. Barrison was to receive his income on these properties.

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Mr. Moran: When you say "his," you mean Mr. Shuck's?

The Witness: Mr. Shuck's income, and that Mr. Shuck had not made any written assignment of that income.

Mr. Blumner: You mean as of that time?

The Witness: Yes.

The other \$20,000 he claimed represented his personal check which he had drawn against a deposit of

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currency on the same date in the amount of \$20,000.

I asked him where that money came from and he said that was money he had which he had accumulated over a period of time without otherwise disclosing where it came from.

In addition to that, there were some further questions in connection with the firm's capital position which resulted from this situation: as of August 30, 1956, their books reflected debit balances of customers' cash accounts in a total amount of approximately \$142,000 in approximately 120 accounts.

Of that amount about \$83,000 was the result of debit balances in 58 accounts arising from purchases by customers on more than seven full business days prior to August 30th.

I established that Shuck is subject to Regulation T since its books reflected transactions through the medium of members of National Securities Exchanges and as such Shuck himself was subject to the regulation and was therefore under the regulation obliged to cancel those trades on or before the expiration of seven full business days, or obtain extensions of time from the proper authorities.

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He did neither, so that the securities remained on hand except that they were in customers' accounts

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rather than in the firm's inventories where they belonged had he complied with the regulation. Had that been done, the firm's inventory position would have been increased to roughly \$83,000 worth of securities against a cost of \$83,000.

In other words, merely reversing the charges to the customers, and the firm's capital position would then be subjected under Rule X15-C(3)(1) to a 30 per cent capital deduction of roughly \$30,000 which by of itself would have resulted in a capital position not in compliance with the rule.

Hearing Examiner Ewell: To what extent?

The Witness: That by and of itself would have resulted roughly, as I say, in a reduction of about \$25,000, and since there was only about \$3,000 excess on the basis of accepting the books as they were, would have resulted in a deficiency of capital of at least \$22,000 apart from the treatment given the \$40,000 to which I previously referred.

I also noted that on August 31st the blotters of the firm reflected certain payments of expenditures of roughly about—there was a total of about \$5,300 as against income on that day of about \$2,400 so that the firm's capital position on August 31st was adversely affected by its expenditures to the extent of \$2,900 which by and of itself also practically elimi-

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nated any surplus that existed on August 30th if everything were accepted at their face value.

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Hearing Examiner Ewell: What was the date of this \$40,000 deposit?

The Witness: It appears on the books as August 29th, the day previous to the date of my figures.

By Miss Evers:

Q. Was Mr. Shuck ever asked to explain these figures to the Commission? A. I reported this matter to the office and my understanding——

Mr. Pollack: I object to the form of the answer.

* * * * *

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By Mr. Moran:

Q. After your visit to Mr. Shuck's office on the particular day that you have described, were there any other conversations you had with Mr. Shuck over and above what you have described to the Examiner here today? A. No, sir.

Q. After you completed your examination on the particular day you described, would you state for the record and to the Examiner what you then did with respect to the examination

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which you made pursuant to the ordinary routine of the office?

* * * * *

The Witness: I reported the findings of my examination to Mr. Ferrall who is the chief of the broker-

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dealer inspection section who in my presence conveyed that information to Mr. Devaney of the Legal Division.

Mr. Moran: Your witness.

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Bernard D. Pollikoff—for Commission—Cross

Cross-examination by Mr. Pollack:

Q. Did you make an examination of the checkbook of the Shuck Company when you were down there? A. I don't know what you mean by an examination. I looked at the book only with respect to that particular deposit.

Q. Did you find that the deposit was entered there? A. Yes.

Q. Did it reflect that the money went into the bank account of the Shuck firm? A. Yes, it did.

Q. Did you verify whether the money was there? A. I didn't do that but I believe that the man in charge of the office then showed me deposit slips and I was satisfied that they went into the bank.

Q. In other words, you were satisfied that \$40,300 was deposited on August 29th, 1956 to the credit of the Shuck Company? A. Yes.

Q. To be used for its general purposes? A. Yes.

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Q. You were satisfied also that accepting the records of the Shuck Company of its transactions, of its capital and its customer transactions on August 31st as of the close of August 30, 1956, there was an excess over the rule? A. Accepting the items to which I have called attention, namely, the profit on Midrim and the \$40,000 as capital, and apart from any impact of the transactions in customers' accounts which should have been cancelled, there was compliance.

Q. Did you examine the confirmations of the Midrim transactions? A. Yes, I did.

Q. Were they regular confirmations and appear to be genuine on their face? A. They did.

Q. Did those confirmations appearing genuine to you reflect the profit that was recorded on the books of the Shuck Company? A. They did approximately, yes.

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Q. But you elected to question that profit? A. I did.

Q. You elected to question it not because there was a profit but because somebody had made some money without putting up some money; is that right? A. That was one of the reasons.

Q. Is there any other reason? A. Yes, the fact that the

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transaction appeared to be effected other than through the usual channels. That is, it was a security that was traded on the Toronto Stock Exchange and the confirmations indicated that these particular transactions were not effected on the exchange.

Q. Are you saying to the Examiner that transactions in that security were not made over the counter? A. No, I am not.

Q. You do confirm that such transactions can be made over the counter? A. I presume so, I don't know.

Q. And having been made over the counter and duly confirmed, that the owner of the transaction is entitled to the profit; is that correct? A. If they were bona fide transactions, yes.

Q. Have you any information whatsoever that you wish to draw to the attention of the Examiner that these were not bona fide transactions? A. Other than the information that I have already testified?

Q. Have you any information whatsoever that Mr. Shuck did not own oil interests in the west? A. I do not.

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Q. As a matter of fact, isn't there information in the files of the Commission known to you that Mr. Shuck does have oil interests which are no part of his brokerage business? A. I have no such knowledge. All I can say is that the books didn't reflect any such ownership.

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Q. Is it normal for a broker to reflect personal ownerships outside of the securities business? A. Anything relating to securities particularly with respect to a sole proprietorship in my opinion has to be reflected on his books.

Q. Are you saying to this Examiner that these oil interests in the west were related to securities? A. From what I gather they probably were.

Q. Are you guessing? A. Oil interests can be considered as securities.

Q. Are you guessing? A. I am not.

Q. Do you know anything at all about the nature of these assets? A. I don't.

Q. Did you ask any questions about the nature of the assets? A. I have given you—

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Q. Did you ask any questions about the nature of the oil assets? A. I don't have any recollection of that, no.

Q. Did you ask whether they were security assets or whether they were general oil interests? A. No, I did not.

Q. So as far as you can say, all you are doing is speculating as to whether Mr. Shuck did or didn't own them? A. No, I am not. I am not saying he didn't own them. I am saying that his books didn't reflect ownership of any oil properties.

Q. If they were properties not related to securities, they weren't supposed to be on the books, were they? A. I wouldn't necessarily say that. It was a sole proprietorship and I would think that generally speaking all business interests of a sole proprietorship should be reflected on his books.

Q. You would include his personal investments? A. I would think so.

Q. Suppose that Mr. Shuck owed a hotel bill, would you consider that that personal liability ought to be reflected on his books? A. I would think that from time to time when his

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Bernard D. Pollikoff—for Commission—Cross

books were closed out that accruals should be made for any unpaid expenses.

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Q. Personal expenses? A. Yes, he was the sole proprietor. This wasn't a partnership or a corporation.

Q. How about his family expenses and assets; would you expect those to be reflected on the books of a security concern? A. I think anything that has to do with a business nature should.

Q. In other words, the criteria is whether it is of a business nature; is that right? A. Yes.

Q. And if these oil interests were not of a business nature you wouldn't expect them to be on the books, would you? A. Probably not, no.

Q. You made no inquiry to ascertain the detail of what the oil interests consist of? A. No, I did not.

* * * * *

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Q. The fact is that these transactions as you have described them to the extent that they appear on the books were genuine transactions so far as your information went? A. The only thing I had in mind in raising any question about that \$20,000 was whether in fact that \$20,000 check from Mr. Barrison was money which Mr. Shuck could rightfully use as capital or whether it represented a borrowing for Mr. Shuck. I wanted to know whether or not it was in fact a liability rather than part of his capital.

Q. You asked questions and you got the explanation, and the explanation was that there was no liability involved; is that correct? A. The answer I got was what I have given you, namely, that it represented a deal with Mr. Barrison under which Mr. Shuck was to give Barrison the income from certain oil properties.

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Bernard D. Pollikoff—for Commission—Cross

Q. Assuming that to have been the correct statement of the deal, that was not a liability to be reflected on the books, was it? A. I don't know, I am not in a position to answer that.

Q. You mean you don't know how to interpret whether that is a liability or not? A. I would have to get all the details before I would want to say anything.

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Q. Did you ask for any details? A. Yes, I asked him and that is what he told me.

Q. You were satisfied with that explanation? A. No.

Q. Did you ask for anything more? A. I asked him for an agreement with Mr. Barrison and he said there wasn't any, that his lawyer was then preparing one but I haven't been supplied with one.

Q. Beyond that, you didn't make any inquiries? A. No, I did not. I was relieved of my inquiries in connection with this matter.

Hearing Examiner Ewell: Didn't you ask any questions as to whether or not it was a sale?

The Witness: I was told it was not a sale. I was told that it was merely an arrangement with Mr. Barrison.

Hearing Examiner Ewell: Did you ask him specifically whether or not it was a loan?

The Witness: I believe I did and the answer I got was that it was a deal with Mr. Barrison whereby Mr. Barrison was to receive the income on certain oil properties.

By Mr. Pollack:

Q. Didn't you get the answer that it was not a loan? A. He may very well have given me that answer, I don't remember.

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Q. Didn't you make a notation on your records that you were told it was not a loan? A. I made a record of what my recollection was at the time of what he said it was.

Q. What is the record that you made at that time? A. Just what I have testified to.

Q. Where is it, do you have it in front of you? A. I have a memorandum here which indicates that Mr. Shuck told me that he made a deal with Mr. Barrison under which Mr. Barrison was to receive the income from certain oil properties.

Q. Let me see that memorandum, will you please?

The Witness: Is it all right for me to give it to him?

Mr. Moran: We have what purports to be an exact copy of what he has in his hand, sir (handing document to Mr. Pollack).

By Mr. Pollack:

Q. Is this a copy of it? A. Yes. What I have reference to is in the first paragraph on page 4.

Mr. Pollack: I would like to read into the record from the memorandum which the witness used to refresh his recollection the paragraph on which he relied as part of the cross-examination of the witness, if

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that is agreeable. "As to the \$20,000 Barrison check, Shuck stated that he had arranged a deal with Barrison resulting in the latter giving him that check in return for the income to be obtained from certain interests in oil wells owned by Shuck which according to Shuck have a value in excess of \$100,000.

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"Shuck, who confirmed the fact that such oil properties were not reflected on his books, stated that no assignment of the properties had been made to Barrison, but that he, Shuck, nevertheless considered the funds so advanced to himself as fully "secured." Shuck stated that no written agreement had been executed with Barrison but that his (Shuck's) attorney was preparing one."

By Mr. Pollack:

Q. Did you have occasion to receive from the Shuck firm weekly trial balances of the business of the Shuck Company during September, October and November of 1956? A. I did not.

Miss Evers: Objection, your Honor.

Hearing Examiner Ewell: What is the ground of your objection?

Miss Evers: The order of the Commission limits the inquiry from August 22nd to September 6th and

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therefore any trial balances submitted to the Commission after September 6th would not be relevant to these proceedings.

Mr. Pollack: It certainly goes to the question of any wilfulness.

Hearing Examiner Ewell: I think it goes to the character of the Respondent's operations in the way he conducted his business. I think it has general relevancy.

Miss Evers: I will withdraw the objection.

Hearing Examiner Ewell: You may answer the question.

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Bernard D. Pollikoff—for Commission—Cross

The Witness: I personally didn't have any more to do with this particular matter after I completed my work as of August 30th.

By Mr. Pollack:

Q. Who did? A. I filled in for a man who had this assignment and who was ill at the time, and when he got back he resumed the assignment.

Q. What is that man's name? A. Joseph Barton.

Q. To your knowledge as a result of your presence in this office did Mr. Barton receive these weekly trial balances?

A. I am not familiar with this matter after I got through

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with my part in the assignment.

Q. Mr. Pollikoff, isn't it a fact that the securities in the Shuck portfolio and the customers' securities were marketable securities and subject to market fluctuation? A. The customers' securities?

Q. The firm's securities and the customers' securities? A. Yes, I presume so.

Q. And the results of those—— A. I don't know whether they were marketable. I know that in the ordinary course of business they were trading in securities which presumably had market prices.

Q. And that at any particular point of a day the values might be up or the values might be down and they would be changing constantly as the market changed; is that correct, sir? A. In the ordinary course of business with securities that are actively traded I presume that would be so. Whether that was so with respect to their securities, I have no knowledge.

Q. Didn't you examine the portfolio of securities here? A.

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Yes, and I valued them based on the prices in the sheets as at August 30th.

Q. You based them on the closing market prices of August 30th? A. On over-the-counter securities you don't use any

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closing prices. You base it on published quotations in the National Daily Quotation Sheets.

Q. What price do you give it? A. We give them the best price. We take the highest bid price in valuing the long position and the low-asked price in valuing the short position.

Q. According to your experience, that bid price is constantly fluctuating during the course of a business day; is that right? A. I don't know. I presume there are fluctuations in price. Whether that holds true with respect to the particular securities they carried, I don't know.

Q. How long have you been in the securities business? A. For many years.

Q. As a result of that experience don't you know that bid prices change from day to day? A. Certainly they do, and others I have seen remain stationary for long periods of time.

Q. Don't those bid prices frequently change from hour to hour and minute to minute? A. They could.

Q. And wouldn't those changes have an effect on whether the firm is over or under the requirements in the course of any particular day if they are close to the line? A. Well, I presume that could happen where there is a very close condition.

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Q. You have testified that the condition here was that they were over by \$3,000 on August 30th on the assumptions that you made or as it appears from the books; is that right? A. That's right.

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Q. That figure of \$3,000 was subject to increase and decrease in accordance with the market fluctuations, wasn't it?

A. It is not practical to determine their capital position from one moment to the next. I mean you can't keep tabs on quotations one minute after 10 and two minutes after 10 and keep determining the firm's capital position every minute in the day. You can only do it as of the published quotations for that day.

I have no way of determining what the quotations are at any particular time during the day. There aren't any published quotations showing the time at which the quotation for a stock changed. The sheets don't show the time at which those quotations are entered.

Q. Isn't your explanation just given in the last answer the reason for the 30 per cent reserve against the value of securities in calculating the excess or insufficiency? A. I am not sufficiently expert to say why the Commission imposed the 30 per cent deduction.

Q. What was the 30 per cent deduction that you calculated

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for August 30, 1956? A. In determining the capital positions as I arrived at them, I made a capital deduction—a deduction from capital—of 30 per cent on certain long and short positions in the amount of approximately \$37,000.

Q. So that in fact at actual market values, the firm had \$37,000 more capital in its till on that day assuming the validity of the market prices?

Q. [sic] I have made an analysis based on the requirements of Rule X15-C(3) (1).

Q. I understand that. I am asking you the question whether the firm in fact had not \$3,000 of capital but \$40,000 of capital? A. I didn't say they had \$3,000 of capital.

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Bernard D. Pollikoff—for Commission—Cross

Q. I am asking you the question, and please don't think that I am criticizing you. A. You said that I said that they had \$3,000 in capital; I never said that.

Q. We have it established that that \$3,000 represented the excess over the S. E. C. requirements. A. Yes, the excess of the adjusted net capital.

Q. That is right. A. That would be the difference between the current assets and the liabilities less the required deduction from that amount prescribed by Rule X15-C(3)(1).

Q. If you add to that excess of \$3,000 the \$37,000 of exist-

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ing market values of the capital securities, the firm in fact had \$40,000 of capital on August 30, 1956; is that right? A. I can tell you how much capital they had before the deduction prescribed by the rule was made, if you want to know that.

Q. Yes, please. A. They had net current capital, that is the difference between the liabilities and current assets, of \$51,000.

Q. Thank you. A. But the \$37,000 deduction was made pursuant to the requirements of the rule.

Q. Do you have any knowledge whether or not every customer of the Shuck Company has been paid in full? A. I do not.

Mr. Pollack: That is all.

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The Witness: I have information here which shows that on August 29th they wrote off \$24,000 of a previ-

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ous reserve for taxes which appeared to me to be all right and I raise no question about it in my testimony.

*Transcript of Hearings**John J. Devaney, Jr.—for Commission—Direct*

I also have a memorandum here with respect to an amount of approximately \$9,000, a debit balance due from Lober Brothers which was written off to Mr. Shuck's capital account, something which was previously considered to be a good asset but which apparently they later determined had already been paid to Mr. Shuck so they wrote it off.

By Mr. Pollack:

Q. You took no exception to that treatment? A. No, but the fact is that it should have been written off long before that. It previously had been treated as a good asset and it shouldn't have been treated as a good asset.

Q. In your examination as of August 30th and on August 30th this treatment was correct in your opinion? A. On that very day.

Q. It was correct on that very day? A. I presume it was, I don't presume that they would write it off unless they felt satisfied that it wasn't an asset any longer.

I think by and large those are the only other facts that I haven't generally covered in my testimony.

* * * * *

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JOHN J. DEVANEY, JR., called as a witness on behalf of the Commission, and being first duly sworn, testified as follows:

Hearing Examiner Ewell: Your full name, please?

The Witness: John J. Devaney, Jr.; 165 Park Avenue, Shrewsbury, New Jersey.

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John J. Devaney, Jr.—for Commission—Direct

Direct examination by Mr. Moran:

Q. What is your position, Mr. Devaney? A. I am employed as an attorney by the New York Regional Office of the United States Securities Exchange Commission. At the present time I am the chief of the Enforcement Branch.

Q. Mr. Devaney, you were present when Mr. Pollikoff testified a few moments ago? A. Yes, I heard Mr. Pollikoff testify.

Q. You recall Mr. Pollikoff stating that upon the completion of an examination of Shuck's books and records on or about August 30, 1956, that he came back to this office and presented his findings to you and to Mr. Ferrall; is that correct? A. That is correct, sir.

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Q. Will you state for the record what steps if any you took thereafter with respect to the disclosures made to you by Mr. Pollikoff?

* * * * *

The Witness: I must preface my remarks by stating that on August 28th, 1956, we filed a complaint in the United States District Court to enjoin Milton J. Shuck from further violations of the net capital rules, and a temporary restraining order was signed that morning. Upon returning to the office I instructed Mr. Barton to make a further examination of the books and records of M. J. Shuck Company. Mr. Barton was taken ill and Mr. Pollikoff made the ex-

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amination. He came back and reported to me his findings.

During the same period of time I was in conference with Mr. Harry Mencher, who represented to me that

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John J. Devaney, Jr.—for Commission—Cross

he was counsel for M. J. Shuck and M. J. Shuck & Company. Mr. Mencher and I argued the motion for a preliminary injunction before Judge McGohey at which time he brought forth these items heretofore referred to, namely, the crediting of the income tax on the books and records of M. J. Shuck; the Barrison deal, and I told Mr. Mencher, as I told the court, that we had a severe question as to whether those items were properly allowable. Mr. Mencher said to me, "I will bring Mr. Shuck in here for you at any time you want him and he can explain those items."

I said I would be more than happy to have Mr. Shuck appear.

* * * * *

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By Mr. Moran:

Q. Then at no time, Mr. Devaney, did Mr. Shuck appear at this office to be examined for any purpose, including the purpose of his financial condition as it relates to Rule X15-C(3)(1)? A. No, sir.

Mr. Moran: No further questions.

Cross-examination by Mr. Pollack:

Q. Mr. Devaney, during the summer of 1956, did your office under subpoena obtain substantial quantities of the books, papers and records of the Shuck Company? A. We did, sir.

Q. Did those books, papers and records relate to the business conducted by the Shuck concern? A. Yes, sir, they were books and records maintained in the ordinary course of business by a registered broker-dealer, sir.

Hearing Examiner Ewell: When was that?

Mr. Pollack: In the summer of 1956.

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The Witness: It was in August of 1956, as I recall, it was August 27th, or thereabouts.

By Mr. Pollack:

Q. Beginning in September of 1956, and following a con-

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versation that you had with Mr. Mencher, did your office receive weekly trial balances from the Shuck Company? A. Yes, sir.

Q. Under your supervision were those weekly trial balances scrutinized and evaluated? A. The trial balances were requested by me. In fact, if I recall correctly, I telephoned Mr. Mencher and said that while I am waiting to see your client, Mr. Shuck, we would like to send a man in there every week if you will furnish us with a trial balance as of the close of business at the end of each Friday of each week.

* * * * *

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Q. Is there any issue that you are raising as to whether you did get the weekly trial balances? A. No, I raise no issue. They were forthcoming, but how many, I cannot tell you.

Q. You suggested that procedure of Shuck sending in the weekly trial balances in lieu of the alternative of your sending a man down weekly to examine the records; is that correct? A. That is correct.

Q. As a matter of fact you decided not to send a man down weekly because you were receiving these trial balances? A. Not only that, sir, but——

Q. That was one of the reasons? A. That was a minor

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reason. The major reason was our overwhelming work at the moment so that we couldn't spare the man to go down there.

Q. In any event, that was a matter of choice on your part?
A. That is correct.

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Q. Did you receive reports from Mr. Barton as to what those weekly trial balances showed? A. I would say yes, I did receive them. He would tell me briefly in a conversation what he would come up with. At all times the question was whether or not those items that had been raised on August 30th were ever such that we could give him full faith and credit for.

Q. However, giving effect to the increases as they appeared on the books and as they reflected on the trial balances, the Shuck firm was always over the requirement, is that correct,

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assuming that those were correct entries? A. Again I must answer you this way——

Q. According to the reports made to you? A. At no time was I advised that they were under in such a way as to require going back to court again.

That is only because of the items in dispute, sir.

Q. Do you recall, Mr. Devaney, that you initiated the civil proceeding in the United States District Court on the basis of the investigation of Mr. Barton made on August 23rd reflecting the August 22nd position?

* * * * *

A. That's right, August 28th.

Transcript of Hearings
John J. Devaney, Jr.—for Commission—Cross

Q. On the very next day according to the report to you from Mr. Pollikoff, August 29th, \$40,300 was added to the capital account of the Shuck Company; is that correct? A. I think it would be a period of two or three days after Mr.

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Pollikoff had completed his examination and had come back.

Q. In other words, the report was two or three days delayed, but he reported to you the very next day that \$40,300 had been put into the net capital account? A. That is right.

Q. Did you call to the court's attention in the course of the argument from the preliminary injunction that \$40,300 had been added to the capital account? A. I didn't, sir, but his counsel did.

Q. I understand that. But you didn't? A. No, I was on the original pleadings as of the date of the violation here.

Q. Did you have any reason for not calling to the court's attention the fact that Shuck had attempted compliance by the very next day after the order to show cause? A. Yes, I did.

Q. Did you feel if you had called that matter to the court's attention that there would be no ground on which the court could issue an injunction? A. You are asking for my opinion?

Q. Yes. A. No; there was full and adequate disclosure of every step that Mr. Shuck took since the time we filed our complaint on August 28th.

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Q. My question is simply this: You came to court with a set of papers that indicated facts as at August 22nd? A. That is right.

Q. I am asking whether you filed any papers with the court to indicate that your investigator had reported to you the

*Transcript of Hearings**John J. Devaney, Jr.—for Commission—Cross*

addition of \$40,300 in cash capital on the day after you filed the papers in the Federal court? A. You want my yes or no answer to that?

Q. If I may. A. No, sir. May I offer an explanation?

Q. In a minute. Let me finish the chronology.

Hearing Examiner Ewell: I will allow an explanation. That question I think should be addressed to me instead of counsel.

The Witness: Before I appeared in court I had been served with papers by opposing counsel, Mr. Mencher, and I was also advised that he was bringing these matters to the court's attention. I see no purpose for me to present matters that properly fall within the defense.

Q. As a matter of presenting the case for the United States

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Securities and Exchange Commission didn't you feel that it was important for the proponent of the client to properly apprise the court as to the capital position of the company at the time that you were arguing the motion? A. No, sir, I do not.

Mr. Moran: Mr. Examiner, I think we are——

The Witness: It was brought to the court's attention.

Q. Not by you? A. No, sir, and if I may by way of explanation again, Mr. Examiner, say that the Commission's complaint alleged a violation as of a particular date, namely, August 22nd, the date of Mr. Barton's inspection. We allege the violation occurred there based on past practices that the violation is threatened in the future.

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Now, if Mr. Shuck was in compliance on August 28th, that is no guarantee to me and I am not required to report to the court that he will be in compliance again on September 1st. That is properly a matter for the defense. It is my argument in my injunction case that the violation has occurred at one time and there are reasonable grounds to believe that the violation will occur in the future.

Q. Were you familiar with the requirements of Section 9 of the Administrative Procedure Act on August 28th when you filed the petition in the Federal court for the order to

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show cause? A. I hadn't even considered the Administrative Procedure Act as respecting any action I would follow in the United States District Court.

Q. Were you familiar with the fact that a registrant is entitled to written notice of claimed underage of capital and a written opportunity to achieve compliance before you could clamp down on him? A. You are asking me that as of now, sir?

Q. Yes. A. Again, I will interpret 9(b) as set forth in the Administrative Procedures Act.

Q. What is your interpretation? A. My interpretation is that if there have been violations in the past it would indicate a wilfull violation and there is no necessity of notice.

Further, I do not believe that the provisions in 9(b) would apply to an administrative hearing such as this here today. The fact is that there is no license involved.

Q. That is your opinion? A. I am giving you my opinion.

Q. You haven't researched it? A. Not the opinion of the Commission, I am speaking only for Mr. Devaney at the moment.

* * * * *

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Q. On August 28, 1956, at the time you argued the motion before Judge McGohey, did you realize that Section 9 and 9(b) of the Administrative Procedure Act related to the licensing and revocation of licenses of a broker-dealer?

* * * * *

Mr. Moran: Before you answer that question—Mr. Examiner, I think you indicated that these matters would more properly fall within argument and in briefs, sir.

Mr. Pollack: What is the fact before we argue about it? I want to find out whether the court was

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apprized of all the facts in the light of what the attorney for the Commission understood the requirements to be. That is a fact, that is not argument.

* * * * *

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A. Yes, I knew that, sir.

Q. At the time that the matter was before the court, you also knew, I think you testified, that \$40,300 had been deposited in the capital accounts of the Shuck Company on August 29th. We have had that? A. Yes, that is true.

Q. Did you have any factual information to indicate that there was any question in relation to that deposit of \$40,300 as a proper addition to the capital of the Shuck Company?

Miss Evers: Objection.

Hearing Examiner Ewell: Read the question.

(Question read.)

Mr. Moran: I believe, Mr. Examiner, that Mr. Pollikoff has already testified with respect to that this

*Transcript of Hearings**John J. Devaney, Jr.—for Commission—Cross*

morning and indicated that there was some question about at least a portion of the \$40,000.

Mr. Pollack: Mr. Moran, I don't think that is a fair thing to do. What Mr. Pollikoff has testified to does not relate to this question or this witness. I don't think it is fair to inject that kind of a statement into this question.

Mr. Moran: My only reason for injecting it at this time——

Mr. Pollack: The question is either proper or im-

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proper and I don't think it calls for a review of what Mr. Pollikoff did or didn't do.

I asked this witness whether he had any factual information which indicated any taint on that \$40,000 as capital. That has nothing to do with——

Miss Evers: Mr. Examiner, this question calls for a review of a decision of a court of competent jurisdiction because all these matters were brought up in the argument before the court. The proper place for such a review is in the higher court, the Court of Appeals.

Hearing Examiner Ewell: That is not the import of the question as I see it. I will have to disagree with you on that. I thought he merely asked whether or not the witness had factual information.

Mr. Pollack: Correct.

Miss Evers: But such information was presented to the court.

Hearing Examiner Ewell: I will rule the question as proper. The witness is under oath and he may answer.

The Witness: The answer, Mr. Pollack, is that I had no factual information either to credit or discredit

Transcript of Hearings
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the item. It was the lack of factual information that created the doubt in my mind as to the item.

By Mr. Pollack:

Q. You didn't lack information as to the actual delivery

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of \$40,000 to the Shuck capital account, did you? A. No, sir.

Q. There was actually \$40,300 in the accounts? A. I was satisfied from the reports of Mr. Pollikoff that the moneys had been deposited, yes, sir.

Q. That was currency, that is, the equivalent of currency?

A. It was a deposit slip. As a matter of fact, I think I saw the deposit slip.

Q. Mr. Pollikoff had also told you that he had made inquiry to ascertain whether the transaction was an actual deposit of free cash or whether it was a loan and he had been told that it was not a loan; is that right? A. No, sir.

Q. Didn't Mr. Pollikoff tell you that he had been told it was not a loan? A. No, sir. Mr. Pollikoff reported to me that it was money advanced by Barrison, and that the runs or the proceeds from certain oil properties owned by Shuck were to be given to Barrison, and that there was an agreement being prepared at the time by Mr. Shuck's attorney. It was based on the lack of what this entire transaction was all about, whether it was a loan, whether it should have been subordinated, whether it was a liability or an asset, I could not determine and would not determine until all the factual information was submitted to me.

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That question was brought up to Mr. Mencher, counsel for Mr. Shuck at the hearing, and I was advised that Mr. Shuck would supply that information to me.

Q. I want to get a precise answer to this precise question:

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Did Mr. Pollikoff report to you that he had asked Mr. Shuck whether this was a loan? A. Mr. Pollikoff did not report to me that he had asked Mr. Shuck whether this was a loan.

Q. Were you here when Mr. Pollikoff testified this morning that he made such an inquiry and was told that it was not a loan, or were you out of the room? A. I was here and I don't recall the question and answer.

Miss Evers: That wasn't testified to.

* * * * *

Hearing Examiner Ewell: I remember trying to refresh Mr. Pollikoff's memory, and I stated: you are a man of experience. I said, now, was this a loan

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or was it a sale? I think that is what I indicated.

He said it was not a sale, and he kept repeating, as I recall it, that using apparently Shuck's words that it was a deal without characterizing it as a sale or a loan. That is one of the very questions that I want to ask Mr. Pollikoff about again.

* * * * *

By Mr. Pollack:

Q. Do you recall, Mr. Devaney, that a memorandum was submitted by the Commission to Judge McGohey, a copy of which you signed, dated September 6, 1956? A. I not only recall it, sir, but I prepared it.

Q. Do you recall that on the argument you pointed out

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to the court that in your opinion there was a serious question of compliance with the rule in that an item of \$20,000 appearing in a capital account of the defendant could under

*Transcript of Hearings**John J. Devaney, Jr.—for Commission—Cross*

the Commission's accounting practice be considered a loan and therefore a liability? A. Yes, I do, sir.

Q. What accounting practice of the Commission were you referring to under which that \$20,000 which appeared free of any entanglements on the books of the corporation could be considered a loan? A. The same accounting practices, sir, that we follow in legal practice: the underlying facts by which this money was placed on the books. Until a full and fair explanation is given of the amount, we do not take it at face value.

Q. In other words, you wanted an explanation? A. That is correct, sir, in order to give it full credit.

Q. And Mr. Pollikoff was there to get that information? A. Mr. Pollikoff had not gone back again.

Q. I say, he was there on the 31st of August and asked Mr. Shuck questions? A. Yes, he did, sir.

Q. That was for the purpose of ascertaining the character of the deposit? A. That is right, sir.

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Q. And the information that he received substantiated the treatment of the item on the books? A. No, sir.

Q. If the information was correct? A. If it——

Q. If the information was correct, it substantiated the item on the books, did it not? A. Mr. Pollack, it was the lack of information that created this problem.

Hearing Examiner Ewell: I would like to ask one question at this point that might clarify things.

Doesn't the memorandum of Mr. Pollikoff state that Mr. Shuck during the course of the examination referred to the fact that there was adequate security in the transaction? Aren't those words in that memorandum?

Miss Evers: Yes, sir.

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Hearing Examiner Ewell: Does not such a statement mean to any person of average intelligence some sort of repayment was involved, and if repayment was involved at any time wouldn't that be at least sufficient evidence to raise a serious question as to whether or not it was in fact some sort of loan?

Mr. Pollack: Are you familiar, Mr. Examiner, with a production lien on oil properties?

Hearing Examiner Ewell: A production lien?

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Mr. Pollack: Yes.

Hearing Examiner Ewell: Only very generally.

Mr. Pollack: Where the sole right of the holder is to receive the income and that that income is secured by the production?

Hearing Examiner Ewell: I would have to read it. I don't know what the word "secured" refers to.

Mr. Pollack: There is no indication in Mr. Pollikoff's memorandum of the matters that I am raising, but you have posed a hypothetical question and I have now raised to you another point which indicates to you that there is no conceivable loan transaction involved in such a transaction, and none the less it is a fully secured matter.

Hearing Examiner Ewell: Wasn't there a statement there about \$100,000? What would be the relevancy of \$100,000 in relation to \$20,000?

Mr. Pollack: The oil wells were worth \$100,000, and if you have a production lien your capital is fully secured.

Hearing Examiner Ewell: Let's read the memorandum. These of course are matters of interpretation.

*Transcript of Hearings**John J. Devaney, Jr.—for Commission—Cross*

Mr. Pollack: The part that was read into the record, just to refresh your recollection, and without reading any further "As to the \$20,000 Barrison check, Shuck stated that he had arranged a deal with

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Barrison resulting in the latter giving him a check in return for the income to be obtained from certain interests in oil wells owned by Shuck which according to Shuck have a value in excess of \$100,000.

"Shuck, who confirmed the fact that such oil properties were not reflected on his books, stated that no assignment of the properties had been made to Barrison; that he, Shuck, nevertheless considered the funds so advanced to himself as fully secured."

* * * * *

Hearing Examiner Ewell: What is the meaning of the word "secured"? It wasn't a loan, so why would there be any security?

Mr. Pollack: It is a production lien.

Hearing Examiner Ewell: I see your point. Nevertheless the whole transaction is fuzzy, to put

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it mildly. It seems to me that there was enough information reported to Mr. Devaney by an employee in the course of his employment to at least raise questions as to the true nature of the transaction.

The Witness: Mr. Examiner, may I ask him to read the next sentence? That is one that created the problem in my mind.

Mr. Pollack: Mr. Blumner has been urging me to read it, and I will be very happy to give it to you:

Transcript of Hearings
John J. Devaney, Jr.—for Commission—Cross

“Shuck stated that no written agreement had been executed with Barrison but that he, Shuck’s attorney, was preparing one.”

The Witness: Very well, and let me bring up, if I may answer that, that was the question raised with Mr. Mencher the first time it was brought to my attention, and I am still waiting today for a copy of the agreement and the understanding under which the money was advanced by Barrison to Mr. Shuck.

by Mr. Pollack:

Q. All this time the \$40,000 was in the bank account? A. I don’t know where the \$40,000 was as of that date.

Q. Let’s examine that a minute. Don’t you know that after the 30 per cent discount, beginning on September 7th,

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1956, the Shuck firm had in excess of \$20,000? A. No, sir, I do not.

Q. —above the capital requirement? A. No, sir.

Q. Don’t you know that that excess capital reached \$35,000 on September 11th? A. No, sir.

Q. You had all the books and records and you could have ascertained that from the books? A. I had no interest in that at that time, sir.

Q. In other words, you didn’t inquire? A. No, I didn’t.

Q. So disregarding the \$20,000, even if you eliminate the \$20,000, if there was excess capital you weren’t interested; is that right? A. No, that is not the problem at all, sir. I had other duties confronting me that I was paying attention to. This case had reached a point and I was sitting and waiting based upon promises made to me for a full explanation at which time I would have gone into the case thoroughly.

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John J. Devaney, Jr.—for Commission—Cross

Q. You were questioning a \$20,000 item and—— A. Only before the court, sir.

Q. And I am calling your attention to the fact that in September of 1956 the Shuck firm showed an excess over

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the capital requirement that ran into the thirty thousands, and that would have eliminated your question, wouldn't it?

A. No, it would not, sir. There was still a question of representation to the court and I am still waiting for the answer from Mr. Shuck.

Hearing Examiner Ewell: What representation to the court?

The Witness: The representation on the part of counsel for the defense that they were fully in compliance. My question to the court is that I didn't know whether they were in compliance or not because I did not know the answer to the \$20,000 or the \$40,000 item.

Q. You were only raising a question as to the twenty and not to the forty, were you? A. It was the one item; the money advanced by Barrison at that time.

Q. \$20,000? A. \$20,000, then.

Q. I am asking you as a matter of simple mathematics, if the excess of capital over the requirements of Shuck exceeded \$20,000, wouldn't your question melt away as to Barrison? A. No, sir.

Q. For purposes of compliance? A. No, sir.

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Q. Did you get an analysis from Mr. Barton as to what the excess over the requirement was at the end of September? A. It may have passed across my desk, Mr. Pollack, but I don't recall it.

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John J. Devaney, Jr.—for Commission—Redirect

Q. Does it refresh your recollection that the excess over the requirement from September 25th to October 1st varied from \$24,000 to \$30,000? A. No, sir.

Q. Do you deny that that is a fact? A. I can't deny something I do not know, sir.

Mr. Pollack: That is all.

Hearing Examiner Ewell: Anything further?

Redirect examination by Mr. Moran:

Q. Mr. Devaney, you have indicated on the record that you were awaiting Mr. Shuck's arrival to answer certain questions in connection with the alleged rejuvenation of the financial condition of the Shuck firm? A. That is correct.

O. One of the questions that you intended to ask was about the Barrison deal? A. That is right.

Q. Did you also intend to ask any questions with respect to the other \$20,000? A. Yes, sir, there were several items that were raised. One item was the carrying of the cus-

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tomers' accounts for a period of more than seven days. They tell me it should have been cancelled.

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Q. Mr. Devaney, the \$20,000 item of cash deposited to Shuck's account, did you intend to ask Mr. Shuck when he appeared with respect to that item? A. Yes, I did. Who reported this to me, I do not know, and whether it was con-

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tained in that memorandum, I do not know, that Shuck took \$20,000 out of his safe deposit box and put it in the bank.

*Transcript of Hearings**John J. Devaney, Jr.—for Commission—Redirect*

Q. What questions did you intend to ask Mr. Shuck with respect to that \$20,000? A. Whether it was his money, or whether there was any obligation to the money. We are dealing with a sole proprietor, and according to what the boys tell me, we can only take what is on the books and give him credit for that.

Hearing Examiner Ewell: I believe Mr. Pollikoff referred to the second \$20,000 of cash which I think he said he had put in the bank in currency. I think that he asked him some questions about it and that Mr. Shuck didn't give any further information. I am not saying he refused, but in any event he didn't get any further information as to the source of those funds.

Mr. Pollack: He was told that it was his funds.

Hearing Examiner Ewell: Did you ever talk to Mr. Shuck, Mr. Devaney?

The Witness: No, sir. I have tried to many times, but I didn't, sir.

Hearing Examiner Ewell: Did he ever appear here at all?

The Witness: No, sir.

Mr. Pollack: Did you ever pick up the telephone

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and call him at his office?

The Witness: Once counsel appeared in the picture, my conversations have always been directed to counsel and I had numerous conversations with Mr. Mencher. I felt it would be a breach if I were to call Shuck myself.

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John J. Devaney, Jr.—for Commission—Recross

Recross-examination by Mr. Pollack:

Q. But you did send somebody in on August 31st then even though he had a lawyer? A. I sent somebody in to examine the books and records of a registered broker-dealer pursuant to Section 17 (a), and I don't think there is any breach of ethics there.

Q. I don't think there was any ethics breached. The door was open to any inquiry you wanted to make. But what you were asking for was a general investigation, wasn't it, Mr. Devaney?

Miss Evers: Objection, your Honor.

Q. You were seeking a general investigation because you were making a general investigation in the securities market generally, and you thought that Shuck fitted into it somewhere, isn't that the fact? A. Mr. Pollack, that is absolutely the fact. I was directed by the Commission to conduct an investigation when you were talking to me in the first part of October and I so informed you that there was a formal order of investigation with respect to the M. J. Shuck Company.

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Q. I asked for a copy of that order. A. I refused to give it to you because you were not certain that you were going to represent Mr. Shuck.

Q. After I wrote you a letter you must have been sure I was going to represent Shuck. A. Between the date I received that letter and the subsequent conversations——

Q. The letter was sent the next day, wasn't it?

Hearing Examiner Ewell: Let him finish. You know, you can't both talk at once.

The Witness: The letter was referred to Miss Evers and I cannot testify for Miss Evers, but Miss

Transcript of Hearings
John J. Devaney, Jr.—for Commission—Recross

Evers had several conversations with you, and she would be more qualified to tell you concerning the order and getting Mr. Shuck into this office.

Q. I don't want to get into any issues of credibility. I am just asking you the question and I think you can confirm, sir, the fact that your interest was in a general investigation, and that was what you were seeking to have Mr. Shuck come in for, and that is why I wanted the order, to see whether you had a right to a general investigation. It was in that connection I suggested to you that you should subpoena Mr. Shuck and give me a copy of the order. Now, do we agree on that? A. We certainly do, Mr. Pollack.

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Q. I have no criticism of the way you carry out your duties. I think you did them well. A. Let me finish my statement for the record, sir.

My duties as an attorney here are to enforce the Securities Act and the 1934 Act and the 1940 Act. During that period of enforcement there are certain problems that arose. There is no doubt whatsoever that there was an order of investigation respecting M. J. Shuck Company. It has been outstanding and it has been exhibited to counsel for Mr. Shuck.

Q. Not me. You are not talking about me. A. I am not talking about you. At times I didn't know who was representing Mr. Shuck and you will have to forgive me for that misunderstanding as to who was in at what time. I would like to, if I may——

Q. If you have implied from my questions any sense of criticism, please disabuse yourself from that because that is not part of my purpose. All I am trying to suggest to you is that one of the reasons why you were having difficulty about having Mr. Shuck come to see you was that you were interested in something much larger than Mr. Shuck, and I was asking you to furnish me with a copy of your authority

Transcript of Hearings
John J. Devaney, Jr.—for Commission—Recross

to conduct any such investigation and subpoena Mr. Shuck so that the matter could proceed regularly. A. May I answer you this way, Mr. Pollack, and you asked me if I had

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the books and records of Mr. Shuck. We subpoenaed the books and records of Mr. Shuck and had two employees of his office show up here accompanied by counsel, Mr. Mencher. The employees were a man by the name of Mertz and a man by the name of Stevens.

Q. The cashier and the manager? A. At that time Mr. Mencher said to me, "Jack, if you want Mr. Shuck you don't need a subpoena, just tell me." I said, "I want to see Mr. Shuck, and I will let you know when it is convenient."

Q. Mr. Devaney, have you any criticism of the suggestions on the part of counsel for a respondent before the S. E. C. that the proceedings go along regularly on proper presentation of orders and subpoenas? You don't criticize that, do you? A. No.

Q. You don't criticize me for asking——

Hearing Examiner Ewell: I think this is getting far afield here. Did you ever request to see Mr. Shuck to question him with reference to this proceeding?

The Witness: You mean——

Hearing Examiner Ewell: On the issues in this proceeding.

The Witness: When you say "issues in the proceeding," Mr. Examiner, I can't answer directly. But the issues involved in the Shuck case involve matters

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other than his financial condition. I expressed the thought that I wanted to see Mr. Shuck with respect to the operation of his business.

Transcript of Hearings
Bernard D. Pollikoff—for Commission—Redirect

Hearing Examiner Ewell: I mean after you appeared on the injunction motion in the Federal court, did you subsequent to that or prior to that ask Mr. Mencher who was then, I believe, appearing in behalf of Mr. Shuck and advise him that you wanted to see Mr. Shuck and question him about the issues in this proceeding; that is, whether or not he was within compliance with the net capital rule?

The Witness: Yes, Mr. Examiner. But, as I say, I just said that I wanted to see Mr. Shuck about this particular financial picture. My statement to Mr. Mencher was that I wanted to get this question straightened out about the Barrison obligation, et cetera, and I wanted to talk to Shuck on other things. It was a general request. He said, "You may have Mr. Shuck here."

Hearing Examiner Ewell: But he never appeared; is that correct?

The Witness: Not to my knowledge.

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BERNARD D. POLLIKOFF, having been previously sworn, was recalled, and testified further as follows:

Hearing Examiner Ewell: Mr. Pollikoff, just tell me in a few words about your background. Are you an accountant?

The Witness: I have been working for Wall Street

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firms primarily on their books going back for about forty years. That includes the period of time that I worked with the Commission, which is about twelve years, sir.

Transcript of Hearings
Bernard D. Pollikoff—for Commission—Redirect

Hearing Examiner Ewell: Do you have a degree in accounting?

The Witness: No.

Hearing Examiner Ewell: You have had practical experience in accounting?

The Witness: Yes, a great deal.

Hearing Examiner Ewell: You are familiar with accounting?

The Witness: Yes, that is correct.

Hearing Examiner Ewell: So that you in that course of time certainly have acquired some knowledge of the nature of loans and sales regarding securities and other matters as well; is that right?

The Witness: That is correct.

Hearing Examiner Ewell: I am a little bit concerned in my own mind as to why your questions to Mr. Shuck apparently have left the nature of this transaction as to the \$20,000 in what I might call a fuzzy condition. He described it as a deal. Now, I want you to review the matter in your own mind and see if you have any information that you have not

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already testified about as to the nature of the transaction. Is there anything that he said that would throw any light on that?

The Witness: I don't think so. I think I got whatever information I could from him from my questions, and the essence of that information is in this paragraph that was read into the record. To my mind the only proof of what actually was contained in that agreement with Mr. Barrison could only be proven by some sort of a document setting forth the arrangement, whatever it was.

Transcript of Hearings
Bernard D. Pollikoff—for Commission—Redirect

Hearing Examiner Ewell: When he related the transaction in the manner in which he did, it certainly aroused questions in your mind, didn't it?

The Witness: It aroused a doubt in my mind as to whether or not it was in fact a liability rather than money which Mr. Shuck had a right to use as his capital.

Mr. Moran: If I may add, Mr. Examiner, when Mr. Pollikoff and other gentlemen of similar status go out to make these inspections, while they do a limited amount of interrogation, the basic interrogation is usually done by the lawyer. Their job is to report back whatever suspicious circumstances they may run across. The follow-up is then conducted by the lawyer with the particular respondent or broker-dealer that may be involved.

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I don't think it was necessarily Mr. Pollikoff's job on that particular day to so interrogate Mr. Shuck so that it left the thing crystal clear as to whether it was a loan, liability, asset or anything else.

When he came back and reported to his superiors, we were following it up to frame such questions.

Hearing Examiner Ewell: Did you ask Mr. Shuck any questions as to the nature of the agreement or this deal?

The Witness: He said that there hadn't been any agreement yet but a lawyer was supposed to have been drawing one up. My recollection was that he said he would give us a copy of it when it was drawn up.

Hearing Examiner Ewell: I take it you didn't ask him any direct question as to just what the nature of the transaction was?

Transcript of Hearings
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The Witness: I did and the only thing I can tell you is what I have already said. It was some sort of an arrangement whereby Mr. Shuck was going to turn over the earnings from certain of these oil properties, and that he had made no assignment to these oil properties, and that he was going to incorporate the agreement in some sort of a written document which his lawyer would prepare.

Hearing Examiner Ewell: You didn't ask him the nature of these oil interests?

The Witness: No, except I think that he said

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something about oil wells or certain oil properties which he acknowledged were not shown on his books in any way. He told me that in his opinion they had a value of over \$100,000 and so that this advance to him was in his mind fully secured. That of course in itself raised a question as to whether or not in fact it was a loan.

Mr. Blumner: May I ask a question?

Hearing Examiner Ewell: Yes.

By Mr. Blumner:

Q. Did you not participate in an investigation of oil royalty dealers generally here in the New York area? A. No.

Q. Don't you recall doing inspections of oil royalty dealers? A. I didn't participate in that investigation.

Q. Are you familiar with the expression or term "production lien"? A. No, I am not.

Q. Have you ever heard it? A. I may have heard it, but I don't recall.

Q. You heard the expression "oil royalty"? A. Yes.

Q. You have heard the words "fractional interests in oil

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and gas"? A. Yes, I have.

Q. You have heard "oil payment" as an expression? A. You mean runs on properties?

Q. Runs on paying oil wells? A. Yes, I have.

Q. Was there anything that Mr. Shuck told you that was inconsistent with the assignment to Mr. Barrison of a production lien on producing oil wells in payment for the \$20,000? A. Yes. It still left the question in my mind as to whether or not it wasn't a loan which was going to be in time reduced by these payments. But at that particular moment he——

Hearing Examiner Ewell: Just a minute. As I recall your testimony, you said he told you there was no assignment.

The Witness: That's right. I asked him whether there was an assignment and he said there wasn't any.

By Mr. Blumner:

Q. As yet. There was an agreement in the process of being prepared? A. Yes, and he said he would send me a copy of it and I never got it.

By Mr. Pollack:

Q. So that if he had told you that this was a production lien situation that wouldn't have had any impact on you

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because you wouldn't understand what a production lien was? A. Not necessarily. I would have reported the facts just as I have reported nevertheless, and let the attorneys decide whether or not in fact the money represented a loan or not.

Q. You know you are privileged to raise any questions

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in your own mind that you want to raise, but whether they are reasonable questions is another matter. A. Probably. The office thought they were reasonable.

Q. Based on your report, anything was reasonable, I suppose. But if this was a production lien you wouldn't have understood the nature of such a deal, would you, because you don't understand production liens? A. If I were told that this was a production lien, I would have asked Mr. Shuck what was meant by it.

Q. Mr. Shuck told you what he meant by saying that Mr. Barrison was going to get the income? A. That's right.

Q. You didn't understand how that related to an oil well situation, did you? A. I certainly did understand. I can understand income from any kind of property.

Q. You understand that Mr. Shuck owned property—
A. Yes.

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Q. And that Mr. Barrison was going to get the income from the property? A. That's right.

Q. And from that you raised a question in your mind as to whether there was a loan? A. As to whether or not that money given by Mr. Barrison to Mr. Shuck didn't in fact at that time represent a loan.

Q. And it is your concept of a loan that the way you repay a loan it is to be paid in income; is that it, instead of principal? A. Not necessarily.

Q. What is the characteristic of a loan? Isn't it that principal is being repaid instead of income? A. Income was being paid——

Q. I say, is it not a characteristic of a loan that the loan is paid back by the payment of principal? A. The amount of the loan would be paid off.

Q. By principal payments, is that right? By a piece of the oil well? A. Not by a piece of the oil well. By money, I don't care where the money comes from.

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Q. You don't care whether that particular money has merely bought an income purchase, so that wouldn't make any difference to you in your evaluation? A. I don't think so.

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Q. Did you report to the staff that you didn't know anything about oil income payments? A. I didn't see any need for reporting any such thing.

Q. Did you report it? A. I reported exactly what I have put in my memorandum.

Q. Did the staff to your knowledge know that you don't know what oil income payments represent and what kind of a deal that represents? A. I——

Q. Did you ever convey that information to the staff? A. I can only tell you what Mr. Shuck told me and what I reported.

* * * * *

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Q. Did you know that after you made your request for oral information, and Mr. Shuck gave you oral information, that he signed and swore to and filed an affidavit as to his capital position? A. No, I have no knowledge of that.

Q. You didn't know that such an affidavit had been supplied and that is the affidavit that Mr. Devaney talked about? A. I had no interest in the matter after I completed my assignment.

Q. You didn't know that Mr. Devaney asked somebody on the staff to check on that affidavit and see whether it reflected the capital position? A. I had no interest in it and it wasn't any part of my assignment.

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Mr. Moran: Mr. Examiner, I think you will recall that Mr. Pollikoff testified this morning that because of the illness of Mr. Barton he stepped in to help on

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a particular chore. When he finished that chore and Mr. Barton's health was restored, then Mr. Barton took over.

Hearing Examiner Ewell: That is correct, yes.

* * * * *

JOSEPH BARTON, having been previously sworn, was recalled and testified further as follows:

Recross-examination (Cont'd.) by Mr. Pollack:

Q. Mr. Barton, do you have the September 1956 statements that were filed by Shuck as to his capital position?

A. Yes.

Q. Would you be good enough to take any one for the latter part of September that you have?

(Witness examines documents.)

A. The 28th of September.

Q. Have you made an analysis of the capital position as shown in that statement? A. Yes, I have.

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Q. What is the excess that you find there of capital over the requirements? A. \$31,000.

Mr. Pollack: Thank you very much. No further questions.

Redirect examination by Miss Evers:

Q. Mr. Barton, does your analysis give credence to the items spoken of in Mr. Pollikoff's testimony so as to arrive at this capital? A. It reflects the books and records of M. J. Shuck at that time, accepting everything on the books and records as being all right. Until Mr. Shuck came in, we were analyzing the books as they showed the items.

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Q. As they show without questioning any items? A. That's right.

* * * * *

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By Mr. Pollack:

Q. Mr. Barton, if you eliminate the \$20,000 from the Barrison source, the figure that you gave as \$31,000 in excess of the requirements would be reduced to \$11,000? A. That's right.

Q. It would still show an \$11,000 excess over the requirement? A. Why would you only eliminate Mr. Barrison's \$20,000?

Q. Because that is what I asked you to do. A. I see. But that would be only one of the items.

Q. I am satisfied that you will make an excellent lawyer, but this is not the occasion.

Mr. Pollack: That is all.

Mr. Moran: I have nothing further.

* * * * *

Hearing Examiner Ewell: On the record.

I would like to ask counsel for the respondent here about this agreement regarding the \$20,000. The matter seems to be in mid-air, and it is a disputed situation. Of course, a copy of that agreement would clarify the matter.

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Do you have a copy of it? Can you supply it for the record, or are you willing to?

* * * * *

Mr. Pollack: I certainly wouldn't supply any information from any conversation I had with Mr. Shuck. I don't think it would be appropriate as a lawyer to do so.

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I will call your attention to the fact that there is nothing that impugns the integrity of the books except some speculation on the part of persons who were not familiar with the subject matter that was being discussed.

* * * * *

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Miss Evers: If Mr. Ray Wagner, a securities investigator in this office were to testify, he would testify as follows:

During a broker-dealer inspection of the books and records of M. J. Shuck Company, during the inspection in the summer of 1955, it was indicated that the defendant had an adjusted net capital deficit of \$218,254.84 as of November 30, 1955.

Mr. Shuck was advised of the rules requirements on December 6, 1955, and he stated that he would obtain subordination agreements and then conformed agreements would be obtained for moneys borrowed.

On December 21, 1955, in a conference with Irwin Fromberg, an associate of M. Mac Schwebel, Mr. Shuck's attorney, he was advised of Shuck's financial condition and Shuck had given this office a simple

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subordination agreement on that Barrison \$35,000 item, but not on any of the other items, and that this agreement was not in compliance with our rules.

During a conference in the office of the S. E. C. with Mr. Fromberg, Mr. Shuck, John Addison, Shuck Company's accountant, and Philip Wagner, then an attorney of this office, on January 10, 1956, Shuck produced simple subordination agreements and items

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and gave assurance that conformed agreements would be secured and filed with this office.

On January 20, 1955, a rough draft of a conformed agreement was submitted to Mr. Wagner. Mr. Wagner resigned from the staff and another draft was submitted on March 21, 1956.

Mr. Ezra Weiss of this office phoned Mr. Fromberg and suggested that certain changes be made and Mr. Fromberg advised Mr. Weiss that the suggested changes would be noted in his files since he was severing his connections with Mr. Schwebel.

On April 3, 1956, Lloyd Frank, of Mr. Schwebel's office, stated that he had an appointment with Mr. Shuck and John Addison for the company and would attempt to conform the subordination agreements to comply with our rules.

On April 9, 1956, Mr. Frank stated that the subor-

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dination agreements had been signed and would be filed shortly. On May 17, 1956, Frank stated that he had forgotten about the agreement and he believed one loan had been repaid and would be recalled on May 18th.

On May 21, 1956, Mr. Frank stated he would file agreements today and that he would call later in the day. He didn't call again.

On May 23, 1956, Mr. Wagner was told by the telephone operator of Mr. Frank's office that he was out of town and he would return on May 24, 1956.

On May 24, 1956, Mr. Wagner called Mr. Frank and was told that Mr. Frank was not in, and a request was made that he return the call and Mr. Wagner left his name. The call was not returned.

On May 25, 1956, Mr. Wagner called Mr. Frank and

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was told that Mr. Frank was in conference. Mr. Frank did not return that call.

On June 29, 1956, Mr. Wagner again returned to the firm of M. J. Shuck Company and conferred with Mr. Shuck and John Addison, C. P. A., the accountant for the Shuck Company. The firm's financial position as of June 15, 1956, computed in accordance with Rule X15-C(3) (1) was disclosed to Shuck as not being within the requirement of the rule as the aggregate indebtedness was \$251,549.26, the required adjusted net capital was \$12,577.46, the net capital was \$51,265.29,

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less a 30 per cent market value on proprietor's securities of \$48,376.43, leaving an adjusted net capital of \$2,888.86.

Hearing Examiner Ewell: Would that be in excess or would that be a lack of compliance?

Miss Evers: It would not be in compliance.

Mr. Moran: As I understand from what Miss Evers has said, the figure of \$2,888.86 was an amount needed by the Shuck firm on that date to be in compliance with 15-C(3) (1).

Hearing Examiner Ewell: That is not what I understood her to say.

Miss Evers: The requirement on the date of June 15, 1956, to meet the net capital rule X15-C(3) (1) would be approximately \$10,000.

Due to the lack of conformed subordination agreements filed with the Securities and Exchange Commission, as required by our rules, Milton J. Shuck, doing business as M. J. Shuck Company, was not in compliance with the net capital rule from November 30, 1955 up to and including June 15, 1956.

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Mr. Pollack: Will you stipulate, Mr. Moran, that at no time from November 1955 through June, 1956, was there ever written notice of claimed deficiency of capital requirement and written opportunity to achieve compliance furnished to Mr. Shuck?

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Mr. Moran: I will stipulate, sir, that there was no written communication given to Shuck. By that I mean a letter from this office or any other office of the Commission, to my knowledge, in which we stated, among other things, that he was not in compliance of 15-C(3)(1). However, I don't know what you mean by the other half of your question.

* * * * *

Miss Evers: I would like to correct my last statement and say that from January 18, 1956, up to and including June 15, 1956, the net capital deficit of M. J. Shuck, doing business as M. J. Shuck Co., was due to the lack of conformed subordination agreements as required by our rules.

Mr. Pollack: You will admit that there were subordination agreements and the only question you raise is whether your form or their form was the appropriate one?

Miss Evers: No.

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Mr. Pollack: Do you deny that there were in fact subordination agreements?

Miss Evers: The subordination agreements filed with us did not meet the requirements of rule X15-C(3)(1).

Mr. Pollack: But there were subordination agreements.

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Mr. Moran: Yes, there were subordination agreements in existence.

Hearing Examiner Ewell: Of sufficient amount?

Mr. Pollack: Of sufficient amount.

Mr. Moran: Put it this way: As I understand the picture, if the subordination agreements had been reduced to meet the form, technique and requirements of 15-C(3)(1), then the Shuck firm would have been in compliance with 15-C(3)(1) as of January 18, 1956.

Mr. Pollack: Also as of June, 1956. Is that correct, Mr. Wagner?

Mr. Wagner: As of June 15th they would have been in compliance if the subordination agreements had been conformed, but I have a question on that.

Hearing Examiner Ewell: What is the value of that kind of testimony if there is no concession as to the validity of the subordination agreement? If that matter is in issue, I don't know how the matter can be evaluated.

Mr. Blumner: Mr. Examiner, this whole thing may

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turn upon the question of the Commission from time to time changing the form of subordination agreements it likes to receive from brokers and dealers with respect to subordination loans. The Commission has from time to time changed its forms. Attorneys do not necessarily keep abreast with the most recent forms. From the recital that Miss Evers gave of the chronology of events, it is apparent that over a period of several months this thing was being shuffled around between Mr. Fromberg, Philip Wanger of this office, who subsequently resigned—Mr. Fromberg resigned from his firm, Mr. Frank was apparently busy on other

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matters, and Mr. Shuck having obtained subordination agreements and having put the matter in the hands of his attorney to meet the requirements of the S. E. C. presumably sat back incapable of doing anything more than he was doing at the time to meet compliance.

Hearing Examiner Ewell: That is why I asked the question. It seems to me the record ought to have something that would determine at least the validity of the subordination agreement.

Mr. Blumner: There is no question about it that the agreements that were filed with the Commission were subordination agreements, whether or not they complied with the rules, is there, sir?

Mr. Moran: As I understand it, Mr. Examiner,

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there were subordination agreements in existence. These subordination agreements did not meet the requirements of Rule 15-C(3)(1) as we interpret it. Now, if it would clarify the situation in any way, and if we had them in our possession, I would be happy to introduce, subject to the approval or disapproval of the opposition, the subordinated agreements of M. J. Shuck, and why we didn't think they were in compliance.

Mr. Blumner: I don't think it is necessary to pull that in as an issue in this case. I am just pointing out that this does not bear upon the wilfull violation by the respondent herein. He had gone as far as he could to obtain compliance. He had agreements, he had submitted the matter to his attorney, and his attorneys were trying to find out just what the form should be and carry it on from there and this thing just ran along for months. But at all times there

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were subordinated loans supplying the requirements of capital, subject to the adequacy of the form of those agreements.

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Mr. Pollack: I would concede that Mr. Wagner would so testify.

* * * * *

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RAYMOND J. WAGNER, called as a witness, and being first duly sworn, testified as follows:

Hearing Examiner Ewell: Your full name?

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The Witness: Raymond J. Wagner.

Direct examination by Miss Evers:

Q. What is your address? A. My address is Barberry Road, Morristown, New Jersey.

Q. What is your occupation? A. I am a securities investigator employed by the United States Securities and Exchange Commission. At the present time I am assigned to the New York Regional Office in the broker-dealer inspection section.

Q. In the course of your official duties with the Securities and Exchange Commission, did you visit the office of Milton J. Shuck, doing business as M. J. Shuck Co. to examine the books and records of said company? A. I did.

Q. On what date did you visit the office? A. My first visit was on November 10, 1955.

Q. Could you tell us what you found at that time?

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Mr. Pollack: May I have a continuing objection and exception to all of this testimony relating to this remote period as not connected with the period August 22nd to September 6, 1956, and that will save my time and your time with specific objections?

Hearing Examiner Ewell: Yes. You object to it and I will overrule the objection because I believe it is relevant.

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By Miss Evers:

Q. When did you complete your inspection of the books and records of M. J. Shuck? A. I was in the office of M. J. Shuck Company on many dates up until sometime in June, 1956.

Q. When you visited the office the first time on November 10th, what did you find at that time? A. I will recite the procedure that I followed at that time.

I did ask for a trial balance of the firm's assets, liabilities, income and expenses as of October 31, 1955. I was advised by Mr. John Addison, a certified public accountant of 30 Broad Street, New York City, to whom at that time I was referred by Mr. Shuck in reference to accounting matters, that such a trial balance had not been prepared since a report of financial condition had been filed with the Commission under date of October 6th. He was in the process at that time of revising the records and he would prepare a trial balance as of November 30, 1955.

I requested a trial balance of Mr. Addison as of November 30, 1955 of the assets, liabilities, income and expenses of the firm of M. J. Shuck Company.

Q. On what date did you receive such trial balance?

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A. I received it a day or so after November 30th; the exact date I don't know. That was the first trial balance I received.

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By Mr. Devaney:

Q. What did you find from the analysis of the trial balance submitted to you? A. Going back to my previous statement, I was given three trial balances in the course of my work. I refer now to the second one which I received, and I gave the facts with respect to the computation which I made in concerns with Rule X15-C(3) (1). I found that they had net capital of \$1,693.80. I then deducted 30 per cent of the market value of the proprietary securities which amounted in dollars to \$219,948.61 which gave an adjusted net capital deficit of \$218,254.81.

* * * * *

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Q. Mr. Wagner, continue with your analysis of the second trial balance. You were up to the deduction from the proprietary securities. A. The aggregate indebtedness was \$45,835.62; the required adjusted net capital was \$2,291.78.

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Q. Did you reach a figure from your analysis as to how much capital was necessary to be in compliance with Rule X15-C(3) (1)? A. They needed \$220,546.59 to bring the financial condition within the requirements of Rule X15-C(3) (1).

Hearing Examiner Ewell: How did you arrive at that figure?

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The Witness: I added the net capital deficit to the required adjusted net capital, which would be the figure which I just gave. That would be \$218,254.81 plus \$2,291.78.

By Miss Evers:

Q. Mr. Wagner, did you bring this to the attention of Mr. Shuck? A. I did.

By Mr. Devaney:

Q. Mr. Wagner, will you tell us the facts and circumstances under which you brought this to the attention of M. J. Shuck Company, or Mr. Shuck? A. On December 6th in the office of Mr. Shuck I brought the facts of the financial condition to his attention. At this time Mr. John Addison was in attendance.

Q. Was this by means of oral statements to Mr. Shuck and Mr. Addison? A. Yes.

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By Miss Evers:

Q. These figures you conferred with Mr. Shuck and Mr. Addison on December 6, 1955? A. Yes, I did.

By Mr. Devaney:

Q. Did you have any further conferences with Mr. Addison or Mr. Shuck or anyone representing Mr. Addison or Mr. Shuck? A. I did.

Q. When, sir? A. On December 14, 1955, by telephone when I was in Mr. Shuck's office, I advised him that it appeared that his firm was still not within the requirements of the rule because of the apparent non-reduction of his short position in the stock which I was interested in at the time.

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Q. You say by telephone. Mr. Wagner, do you mean you telephoned Mr. Shuck from his own office? A. I didn't telephone him; I was attempting to get in touch with him and I was put on the wire when he called in.

Q. He was not present at the office when you reported these figures to him? A. That's right.

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Q. Did you have subsequent conferences with Mr. Shuck or with anyone representing him? A. On December 21st, in the office of M. Mac Schwebel, attorney, at 30 Broad Street, New York City, I discussed this situation with Irwin Fromberg.

Q. Can you identify Mr. Fromberg for us? A. He is an associate or in the office—I believe he is associated with Mr. Mac Schwebel. What his status is, I do not know.

Q. What was present at this conference, Mr. Wagner? A. Just Mr. Fromberg and myself.

Q. Mr. Wagner, can you tell me if you made any further analysis of the figures of the M. J. Shuck Company as of, for example, December 31, 1955? A. I did.

Q. On what did you base that analysis? A. I based that on the trial balance prepared by John Mertz employed by M. J. Shuck Company, which trial balance as to accounts and money balances I checked in the general ledger.

Q. Tell us the results of your analysis of that trial balance, sir? A. I determined that the net capital deficit was \$72,444.55. To that I added 30 per cent of the market value of the proprietary securities in the amount of \$189,591.10,

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which gave an adjusted net capital deficit of \$262,035.65. The aggregate indebtedness was \$12,446.40. The required adjusted net capital was \$622.32. The deficiency amounted to \$226,657.97.

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Q. Mr. Wagner, did you in the performance of your official duties at any time report the results of your analysis of these trial balances to any of your superiors or any other employees of the Commission? A. Yes. At this time I was working in collaboration with Philip Wagner, an attorney on the staff of the Commission in the New York Regional Office.

Q. Did you discuss or determine in your own mind, Mr. Wagner, what steps should be taken to alleviate this situation that you found as a result of your analysis of the trial balances of the M. J. Shuck Company? A. I knew how he could correct it. I had an opinion as to how he could have corrected it.

Q. Did you express that opinion to Mr. Shuck or to anyone? A. No, I did not.

Q. Did you ever advise or notify Mr. Shuck that he was not in compliances with the net capital rule and that he should take certain steps? A. I did confer with him and advise him that he was in non-compliance. The steps he takes are entirely his own.

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* * * * *

On January 6th, in this office Philip Wagner and I conferred with Irwin Fromberg and Addison. When Mr. Fromberg arrived in the office he stated that Mr. Shuck was unable to be present and we advised him at that time—Fromberg—of the capital deficiency as of December 31, 1956. Then as at January 10th, Mr. Shuck appeared with Mr. Fromberg and Mr. Addison and with Philip Wagner I

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discussed the December 31, 1956 capital condition with him.

Hearing Examiner Ewell: Your discussion was in January, but the trial balance was at December 31, 1955?

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The Witness: I guess I said December 1956, in fact, that is what I have here.

During our discussions with Mr. Shuck, the question was raised with respect to Great Sweet Grass Oils, Ltd. As of November 30th after my first discussion with him, which is based on the first trial balance that John Addison made an entry on the books as to the short position of the Great Sweet Grass Oils, Ltd. stock in which he set it up as a "Failed to Receive," where, in fact, they had no firm commitment to purchase the stock. They did have some options in respect of Great Sweet Grass Oils, Ltd. I reversed these entries in my analysis. I took it out of "Failed to Receive" and put it into a short position.

By Mr. Devaney:

Q. Mr. Wagner, did Mr. Shuck or anyone representing Mr. Shuck make any representations to you during January, 1956, as to what they would do with respect to the short position in Great Sweet Grass stock? A. They said that it would be reduced and it was reduced.

* * * * *

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The Witness: As of January 18th, for all intents and purposes, they had corrected the Great Sweet Grass Oil situation.

By Mr. Devaney:

Q. How did they correct it, Mr. Wagner? A. With respect to the Great Sweet Grass Oils short position, they bought and paid for a certain number of shares which covered their short position.

Q. Mr. Wagner, after January 18, 1956, through August 1, 1956, did you have any opportunity, or did you request any further trial balances to make an analysis of such a

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trial balance? A. I did make an analysis as of January 18, 1956.

Q. What was your analysis as of January 1956? A. They had an aggregate indebtedness of \$18,093.93. They had a required adjusted net capital at the time of \$944.69. They had a current net capital of \$60,368.52. I deducted 30 per cent of the market value of the proprietary securities in the amount of \$28,066.35, which gave them an adjusted net capital of \$32,302.17.

In arriving at these figures which I have recited, I treated a total amount of \$46,500 as capital. This \$46,500 is composed of three items: the amount of \$35,000, which was borrowed from Barrison; an amount of \$6,000, which was borrowed from Julius Barach, and an amount of \$5,500, which was borrowed from Sidney Katz.

When I originally examined the records of—I say originally, in the early part of my examination of the books and records, a few days of it must have been after the 1st of December when I determined through questioning of Mr. Shuck that these items had been included in his capital account as capital. I inquired as to whether any subordination agreements had been secured from these parties. I was told that no such agreements had been secured. Subsequently, I did secure three subordination agreements with respect to these items. These subordination agreements state simply that the amount owed to the party by M. J. Shuck

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Company was subordinated to the claims of any and all other creditors.

* * * * *

Mr. Pollack: It was a written subordination in each case?

The Witness: Yes.

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By Mr. Devaney:

Q. With respect to the subordination agreements submitted by you, Mr. Wagner, you are familiar with the provisions of Section 15-C(3)(1) with respect to subordination agreements? A. Yes, I am.

Q. Did these subordination agreements meet the requirements of that rule? A. In my opinion, they did not meet the requirements.

Q. Was the point that they were not in accordance with our rule transmitted to Mr. Shuck or to any representative of Mr. Shuck, to your knowledge? A. Yes.

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Q. In order to shorten your testimony, during the period of the next four or five months were there continual conferences going back and forth between the representatives of Mr. Shuck in order to bring these subordination agreements in compliance with our rules? A. Yes, there was.

Q. To your knowledge, do you know whether the proper subordination agreements have been filed with this office? A. Yes.

Q. When were they filed, sir?

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The Witness: July 9, 1956 is the date.

Mr. Pollack: That is the date on which you say the proper subordination agreements were filed with the Commission; is that right?

The Witness: The date which the subordination agreements were filed.

Mr. Pollack: What is the date of the agreements that were filed?

The Witness: October 6, 1955.

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By Mr. Devaney:

Q. Mr. Wagner, during this period of time between January 18, 1956, and the date of filing of the subordination agreements, July 9, 1956, did you have occasion or did you make another trial balance of M. J. Shuck, or was one furnished to you? A. I did.

Q. Will you tell us what happened? Did you take off a trial balance or was one furnished to you? A. One was

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furnished to me and I satisfied myself that the accounts and the money balances shown thereon were reflected in the ledgers of that company.

Q. Will you give us the date of that trial balance, sir? A. May 31, 1956.

Q. As of May 31, 1956, did you make an analysis based on that trial balance? A. I did.

Q. Will you give us the results of your analysis? A. My analysis shows that as of May 31, 1956, M. J. Shuck Company had a net capital of \$43,915.96. Deducting 30 per cent, the market value of the proprietary securities were in the amount of \$89,095.80, and I secured an adjusted net capital deficit of \$45,179.84. The aggregate indebtedness was \$168,240.88. They required an adjusted net capital of \$8,412.04, and the deficiency amounted to approximately \$54,000.

In this computation I included the loans which I previously referred to and which are now reduced to \$36,500 as liabilities, and I included them in the aggregate indebtedness.

Q. Can you tell me of your own knowledge, Mr. Wagner, whether the results of this analysis of the May 31, 1956—

Hearing Examiner Ewell: Let me understand this.

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You mean you disregarded the subordination agreements in this analysis?

The Witness: Yes, I did.

Hearing Examiner Ewell: I thought you said that proper subordination agreements were subsequently filed to the January analysis?

The Witness: As of January 1st in two instances—with dates of January 3, 1956, in two instances subordination agreements were filed which were not within the requirements of the rule. They were simply subordination agreements in that they simply stated that they subordinated the amounts of the claims of any and all other creditors.

At that time on the assurance that the conformed agreements would in due course shortly be filed with us, I treated them in effect as capital.

At this point, because of the passage of time and the non-filing of these conformed agreements, I did not include them as capital.

* * * * *

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Q. Was your analysis at any time told to Mr. Shuck or to any representative of Mr. Shuck in any manner, shape or form? A. This condition was brought to his attention.

* * * * *

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Mr. Devaney: Mr. Examiner, it is stipulated between counsel for the Division of Trade Exchanges and counsel for the registrant that according to the books, records and cancelled check vouchers of the M. J. Shuck Company, and the representation by Mr. Mertz, who was cashier for M. J. Shuck Company, that all customers' accounts as contained in such books

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and records were paid off in full and there are no liabilities of M. J. Shuck Company to its customers.

Mr. Pollack: And it is also conceded that the ledgers referred to and the cancelled check vouchers were here and were examined by your representative in connection with the preparation of this stipulation.

Mr. Devaney: That is correct.

Mr. Pollack: Thank you very much, Mr. Devaney.

Mr. Devaney: Now, Mr. Examiner, I think the question before the witness is in what manner, shape or form did he transmit the analysis of the May 31, 1956 trial balance to M. J. Shuck or his representative?

A. On June 29, 1956, I had a conference with Mr. Shuck in his office. At this conference Mr. Addison was present. I disclosed to him the results of my analysis of the May 31, 1956 trial balance. I also disclosed to him the results of

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my analysis of the June 15, 1956 trial balance.

By Mr. Devaney:

Q. You made reference to a June 15, 1956 trial balance. What was that based on? A. Based on a trial balance prepared by Mr. Mertz, on which I satisfied myself as to the accounts and the account balances, those reflected on the books of the M. J. Shuck Company.

Q. Would you tell me, from your analysis of the June 15, 1956, trial balance, the condition of M. J. Shuck Company with respect to the net capital? A. I determined that the aggregate indebtedness was \$251,549.26; that the required adjusted net capital was \$12,577.46. The net capital was \$51,265.29, from which I deducted 30 per cent of the margin

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value of the proprietary securities in the amount of \$48,376.43, which gave an adjusted net capital of \$2,888.86.

Mr. Pollack: An excess of \$2,888.86, a plus figure?

The Witness: Yes. There was a deficiency of approximately \$9,700. In this analysis as of June 15, 1956, I did not include the \$36,500 total amount of subordinated items in the capital. I did include it in the aggregate indebtedness.

Hearing Examiner Ewell: In other words, you

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again disregarded the subordination agreements?

The Witness: Yes.

Hearing Examiner Ewell: As being effective agreements, agreements in compliance with the rules?

The Witness: Not being in compliance, that's right, sir.

Mr. Pollack: If you had included that subordinated indebtedness, what figure of excess capital would you have had under the rules, just the arithmetic?

Hearing Examiner Ewell: Approximately?

The Witness: Approximately \$47,000. At this time Mr. Addison examined my computation and he had no comments to make in respect to my computation. I then inquired as to what steps would be taken to bring the firm's financial condition within the requirements of the rule. Mr. Shuck stated, sir, that on July 2, 1956, he would deposit \$15,000 of his personal funds in the Shuck Company bank account as an additional contribution and that he would file with the office conformed subordination agreements in duplicate, on the total borrowings of \$36,500, which were subordinated by simple agreements.

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I did request at that time, during my conversation with Mr. Shuck, a trial balance of the Shuck Company's general ledger and customer accounts as of July 2, 1956, if in fact he did deposit \$15,000 on July 2nd as capital.

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Hearing Examiner Ewell: He did?

The Witness: I requested, if he did deposit it, that he give this office a trial balance showing that it was deposited, from which I would compute the capital with the \$15,000 deposited as capital.

At that time Addison stated that the trial balance as of July 2, 1956 would be completed and available by the A. M. of July 6th. I never followed through on the securing of this trial balance.

Hearing Examiner Ewell: Did you ever get it?

The Witness: No, sir, I never got it. With respect to the subordination agreement, Shuck telephoned Lloyd Frank of M. Mac Schwebel's office and advised him that he was sending a messenger for the subordination form. Shuck advised the writer that Schwebel was no longer his attorney.

Subsequently Addison brought a folder into the Shuck office in which subordination agreements were verified by me. Shuck was advised that this office had suggested amendments of the original draft. After examining the papers in the aforementioned file, Addison stated that he believed that the suggestions had been included in the agreements which were in the files. I gave no opinion as to the subordination agreements.

Then, on June 25, 1956, I was advised by Stevens,

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Raymond J. Wagner—for Commission—Cross

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the cashier of the Shuck Company, by telephone, that Shuck was out of town and he expected him to return the evening of 6-26.

* * * * *

Mr. Pollack: You told us about July 2nd and the \$15,000 on the subordination agreements. You have also told us that the subordination agreements in satisfactory form were actually filed on July 9th; is that correct, sir?

The Witness: That's right.

Mr. Pollack: On July 9th?

The Witness: I did.

Hearing Examiner Ewell: Who is Mr. Addison?

The Witness: He represented Mr. Shuck.

Hearing Examiner Ewell: In what capacity?

The Witness: With respect to accounting matters.

Mr. Pollack: He was a certified public accountant; is that right?

The Witness: That's right.

By Mr. Devaney:

Q. He maintains offices at 30 Broad Street; is that correct?

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A. Yes.

Mr. Devaney: I have no further questions, Mr. Examiner.

Hearing Examiner Ewell: Do I understand that the last time you analyzed the trial balance, you did not allow these \$36,000 loans?

The Witness: That's right.

Hearing Examiner: Because subordination agree-

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Raymond J. Wagner—for Commission—Cross

ments in proper form had not up to that time been filed; is that right?

The Witness: That's right.

Hearing Examiner Ewell: But that nine days later such agreements which did comply with our rules were filed; is that right?

The Witness: July 9th.

Hearing Examiner Ewell: I said nine days later. I was wrong on my computation of the period. It was from the 2nd of—that is, from the 2nd to the 9th, seven days?

The Witness: The trial balance was June 15th. The filing was made on July 9th. Also in the May 31, 1956 computation, I did not include the \$36,500.

Mr. Pollack: We have had that.

Cross-examination by Mr. Blumner:

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Q. I believe you stated on the record that on first going into the office of Mr. Shuck, on the first financial date or financial condition that you analyzed, it was November 30, 1955; is that correct? A. Yes.

Q. At that time there was an adjusted net capital deficit of approximately \$218,000? A. Yes.

Q. Am I correct? A. Yes.

Q. In your stating that that was the result of taking out of "fails-to-receive" pair-offs for certain short sales that were not fails-to-receive but were in fact options to buy the securities that had been sold; is that correct? A. Yes, in regard to the second trial balance from which you quoted figures.

Q. What I am saying is that if they were "fails-to-receive," properly so, there would be no such figure as \$218,000 adjusted net deficit. There might have been an adjusted net deficit, but not a figure in that amount? A. It would change it, yes.

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Q. It would change it very materially, would it not? A. Yes.

Q. And that all the way through, am I right, from Novem-

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ber these large adjusted net deficit figures that you are referring to throughout are due to two things: first, the inadequacies or the claimed inadequacies on the part of the Commission's state of the subordination, the two simple subordination agreements, on the one hand, or overly simple subordination agreements, on the one hand, and on the other hand, the fact that there were short positions against options rather than short positions against "fails-to-receive," or sales against "fails-to-receive"? Is that the principal basis on which these adjusted net capital deficits existed throughout the period from November 30th to January? A. What date?

Mr. Pollack: 10th.

Q. I will make it simpler, until June or July of 1956? A. No.

By Mr. Pollack:

Q. I think you testified that on January 18th, they corrected the Great Sweet Grass oil situation by buying and paying for the shares to cover the short position; is that right? A. Yes.

Q. So that between the time that you analyzed the November 30, 1955 statement and January 18th, the reason for the large deficit figure was twofold, in substance: one, that there

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was a non-recognition of the subordinations in the simple form, and, secondly, that you were treating the Great Sweet

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Raymond J. Wagner—for Commission—Cross

Grass Oil situation in the way that has been described? A. No.

Q. Well, what is it? A. Well, as of November 30th, in the second trial balance and the first trial balance, I believe I was not acquainted with the fact of these borrowings.

Q. So that it was attributable not to two things, but only to one thing; that is, the Great Sweet Grass Oil situation, which was corrected by January 18th? A. That's right.

Mr. Pollack: That is all.

By Mr. Blumner:

Q. Thereafter, the capital deficiencies that you note are substantially the result of the non-recognitions of the propriety of the two simple or overly simple subordination forms in very large measure? A. With respect to the January 18, 1956 computation—in fact, the figures I gave first included the \$46,500 as capital, and they were all right. Then I went on, I believe, to point out that if they were—if the total amount of \$46,500 was not included as capital, they would not be within the requirements. Now, on May 31, 1956, they would have a deficit and would not be within the requirements.

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By Mr. Pollack:

Q. According to the June 15, 1956 trial balance sheet—
A. They would be.

Q. If you do not disregard the subordinations, the simple subordinations, there is an excess of capital under the rules; is that right? I think you so testified? A. Yes, I have.

Mr. Pollack: That is all.

The Witness: I was making a statement here—

Hearing Examiner Ewell: What about May?

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Mr. Pollack: Well, the witness testified that as of the May 31, 1956 balance sheet, that there was a small underage if you do not disregard the \$36,500 as subordinated debt.

By Mr. Pollack:

Q. Is that right? A. I don't know as I said small or anything.

Hearing Examiner Ewell: What is the amount?

The Witness: They did have an adjusted net capital deficit of \$45,179.84. If we include the \$36,500 as capital, that would reduce the deficit by the amount of \$36,500.

Hearing Examiner Ewell: And leave it at about \$9,000; is that right?

The Witness: About \$9,000. They needed a required adjusted net capital of \$8,000, which would be a deficiency of \$17,000.

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By Mr. Pollack:

Q. And that corrected itself by June 15th? A. The situation changed entirely. The financial position changed and it worked out.

Mr. Pollack: I think you have given us all the figures we need from our viewpoint, Mr. Wagner.

Hearing Examiner Ewell: Did the short position that was mentioned as to the November situation—did that continue in the other statements, or were there similar situations developed there, or was that correct?

Mr. Pollack: That corrected itself by January. Mr. Blumner raises the question as to whether the

Transcript of Hearings
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treatment of a short position under the May 31, 1956 balance sheet accounted in part for the approximately \$9,000 insufficiency of capital that you have referred to.

The Witness: No. I can explain the large amount of deduction; that is, the deduction of 30 per cent of the market value of the proprietary securities, the Great Sweet Grass Oil at that time did not enter—

Mr. Blumner: I didn't say Great Sweet Grass Oil. I said short positions.

The Witness: At that time that would aggregate nothing, sir.

By Mr. Blumner:

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Q. It aggregated nothing? A. It was the long position. It was in another stock.

Hearing Examiner Ewell: What about the question of non-delivery within the seven days? Was that involved in any of these statements?

The Witness: I did not consider it in my analysis.

Hearing Examiner Ewell: I think it was presented by the previous witness.

Mr. Devaney: Pollikoff; that is right.

Mr. Barton: It was only brought up in his memorandum. I don't believe it was used in his calculations.

Mr. Blumner: I believe the testimony will show that he did use it in his calculation.

Mr. Pollack: I have no further questions of Mr. Wagner.

Mr. Devaney: I have no further questions, Mr. Examiner.

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Hearing Examiner Ewell: Thank you.

(Witness excused.)

Mr. Devaney: Mr. Examiner, I would like to state for the record at this time that counsel for the Division of Trading and Exchanges have completed the presentation of their case.

* * * * *

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Hearing Examiner Ewell: Are you putting in any evidence on behalf of the respondent, other than what has been stipulated to?

Mr. Pollack: No.

Hearing Examiner Ewell: So that both sides rest?

Mr. Pollack: Yes.

* * * * *

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(Whereupon, at 7:15 p.m., the hearing in the above-entitled matter was closed.)

**PRELIMINARY INJUNCTION AGAINST M. J. SHUCK,
INDIVIDUALLY, AND DOING BUSINESS AS M. J.
SHUCK CO.**

IN THE
UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK
(Civil Action, File No. 112-267.)

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

—v.—

M. J. SHUCK, doing business as
M. J. SHUCK Co.

Defendant.

This cause having come on to be heard on the 4th day of September 1956, on the verified complaint filed herein, on the motion for preliminary injunction with supporting affidavits, and it appearing to this Court that the defendant, M. J. Shuck, individually, and doing business as M. J. Shuck Co., was engaged in and about to engage in acts and practices which constitute a violation of Section 15(c) (3) of the Securities Exchange Act of 1934, 15 U. S. C. 78o(c) (3) and it appearing to the Court that the defendant, M. J. Shuck, individually, and doing business as M. J. Shuck Co., unless enjoined, will continue to engage in said acts and practices, it is hereby

ORDERED that the defendant, M. J. Shuck, individually, and doing business as M. J. Shuck Co., his agents, servants, employees, attorneys and assigns, and each of them, be and

Preliminary Injunction

they are preliminarily enjoined from, until further order of this Court, directly or indirectly, making use of the mails or of any means or instrumentalities of interstate commerce to effect transactions in, or to induce or attempt to induce

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the purchase or sale of securities (other than exempted security, or commercial paper, bankers' acceptance or commercial bills) otherwise than on a national securities exchange while and at a time when his aggregate indebtedness to all other persons exceeds two thousand (2,000) per centum of his net capital.

Dated, September 7, 1956.

/s/ JOHN F. X. McGOHEY,
United States District Judge.

A true copy,

HERBERT A. CHARLSON, Clerk,
By C. SALAMONE,
Deputy Clerk.

SUMMONS

[SAME TITLE.]

To the above named Defendant:

You are hereby summoned and required to serve upon Daniel J. McCauley, Jr., William D. Moran, John J. Devaney, Eileen E. Evers, plaintiff's attorneys, whose address is 225 Broadway, New York 7, New York, an answer to the complaint which is herewith served upon you, within 20 days after service of this summons upon you, exclusive of the day of service. If you fail to do so, judgment by default will be taken against you for the relief demanded in the complaint.

HERBERT A. CHARLSON,
Clerk of Court.

RAOUL BRUGO,
Deputy Clerk.

[Seal of Court]

Date: August 28, 1956.

COMPLAINT

[SAME TITLE.]

1. It appears to the Securities and Exchange Commission, plaintiff herein, that the defendant is engaged and is about to engage in acts and practices which constitute and will constitute violations of Section 15(c)(3) of the Securities Exchange Act of 1934, 15 U. S. C. 78o(c)(3), and of Rule X-15C3-1 adopted thereunder, 17 C. F. R. 240.15C3-1, and the plaintiff pursuant to Section 21(e) of the Securities Exchange Act of 1934, 15 U. S. C. 78u(e), brings this action to enjoin such acts and practices.

2. This Court has jurisdiction of this action under Section 27 of the Securities Exchange Act of 1934, 15 U. S. C. 78aa.

3. Pursuant to the authority conferred upon the Securities and Exchange Commission by Section 15(c)(3) and Section 23(a) of the Securities Exchange Act of 1934, 15 U. S. C. 78o(c)(3) and 78w(a), the Commission has prescribed Rule X-15C3-1. Said Rule was in effect at all times mentioned herein and is now in effect.

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4. The defendant, M. J. Shuck, conducts his business under the name of M. J. Shuck Co., and has his principal place of business at 39 Broadway in the City and County and State of New York. Since February 24, 1955, he has been and is now registered as a broker and dealer in securities pursuant to Section 15(b) of the Securities Exchange Act of 1934, 15 U. S. C. 78o(b).

5. The defendant has been and is now engaged as a broker and dealer in securities and as such broker and dealer during the period from approximately August 22, 1956 to date hereof, has been and is now making use of the mails and of the means and instrumentalities of interstate commerce. By such use the defendant has been and is now effecting transac-

Complaint

tions in, and has been and is now inducing and attempting to induce the purchase and sale of, securities (other than exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange. By such use and during the period from approximately August 22, 1956 to the date hereof, the defendant has permitted and is now permitting his aggregate indebtedness to all other persons to exceed two thousand (2,000) per centum of its net capital in contravention of Rule X-15C3-1.

6. The defendant will, unless restrained and enjoined, continue to engage in the acts and practices set forth in this complaint.

WHEREFORE, the plaintiff demands a temporary restraining order and a preliminary and final injunction restraining and enjoining defendant, his officers, agents, servants, em-

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ployees and assigns and each of them from directly and indirectly making use of the mails or of any means or instrumentalities of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of securities (other than exempted security, or commercial paper, bankers' acceptances or commercial bills) otherwise than on a national securities exchange while and at a time when his aggregate indebtedness to all other persons exceeds two thousand (2,000) per centum of his net capital.

DANIEL J. McCAULEY, JR.,
Acting Regional Administrator.

WILLIAM D. MORAN,
Chief Enforcement Attorney.

JOHN J. DEVANEY, JR.,
Attorney.

EILEEN E. EVERS,
Attorney.

**MOTION FOR TEMPORARY RESTRAINING ORDER
AND PRELIMINARY INJUNCTION**

[SAME TITLE.]

The plaintiff respectfully moves this Court to enter a temporary restraining order and preliminary injunction restraining the defendant, his agents, servants, employees, attorneys, and assigns, and each of them, from engaging in the acts and practices specified in the demands of the Complaint filed herein.

This motion is based upon the affidavit submitted in support thereof, upon the fact that the defendant, unless restrained and enjoined, during the pendency of this action, will continue actively to engage in said acts and practices, and upon the fact that the continuance of such conduct on

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the part of said defendant is injurious to the public interest.

DANIEL J. McCAULEY, JR.,
Acting Regional Administrator.

WILLIAM D. MORAN,
Chief Enforcement Attorney.

JOHN J. DEVANEY, JR.,
Attorney.

EILEEN E. EVERS,
Attorney.

AFFIDAVIT OF JOSEPH O. BARTON

[SAME TITLE.]

STATE OF NEW YORK, }
COUNTY OF NEW YORK, } ss.:

JOSEPH O. BARTON, being duly sworn, deposes and says:

I am employed in the New York Regional Office of the Securities and Exchange Commission as a Securities Investigator and have been so employed since October 1948.

On or about August 22, 1956, I was assigned to inspect the books and records of M. J. Shuck, d/b/a M. J. Shuck Co., broker-dealer registered with the Securities and Exchange Commission and a defendant herein, for the purpose of ascertaining, among other things, whether said defendant was observing those safeguards adopted by the Securities and Exchange Commission pursuant to Section 15(c)(3) and Rule X-15C3-1 promulgated thereunder to insure the financial responsibility of brokers and dealers. The said Rule provides that "No broker or dealer shall permit his aggregate indebtedness to all other persons to exceed 2,000 per centum

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of his net capital." During August 1956, pursuant to this assignment, I visited the office of said defendant at 39 Broadway, City, County and State of New York, and conducted an examination of said defendant's books and records. My examination of said defendant's books and records in light of the requirements of said Rule X-15C3-1 disclosed, among other things, the following:

1. That the defendant is a broker and dealer who is making use of the mails or means and instrumentalities of interstate commerce to effect transactions in, or to induce or attempt to induce, the purchase or sale of securities (other

Affidavit of Joseph O. Barton

than an exempted security, commercial paper, bankers' acceptances or commercial bills), otherwise than on a national securities exchange.

2. That the defendant is not a member of any national securities exchange and is not a broker whose business is limited to acting as agent for the issuer in soliciting subscriptions for such securities of such issuer.

3. That defendant's aggregate indebtedness, as that term is defined in Rule X-15C3-1, as of August 22, 1956, is \$266,056.43.

4. That the required adjusted net capital, as that term is defined in Rule X-15C3-1, in view of the foregoing aggregate indebtedness, is \$13,302.82.

5. That the defendant's net capital deficit, as defined in the aforesaid Rule, is \$27,288.58.

6. That said net capital deficit, in accordance with the provisions of said Rule, is subject to certain additions of

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\$31,329.00, representing the prescribed percentages of the market valuations of non-exempt securities, long and short, as of August 22, 1956.

7. On the basis of the aforementioned adjustments, the defendant's adjusted net capital deficit is \$58,617.58.

8. That in view of the foregoing the defendant's deficiency of capital amounted to \$71,920.40, or to state it in another way, the defendant needs \$71,920.40 in order not to exceed two thousand (2,000) per centum limitation on its aggregate indebtedness to its adjusted net capital.

In view of the defendant's failure to maintain sufficient capital in compliance with Rule X-15C3-1, it appears that

Order to Show Cause

unless the sanction of this Court is invoked, the defendant will continue his violations, thereby depriving other brokers, dealers, banks and customers doing business with him of the safeguards with respect to his financial responsibility which the Securities and Exchange Commission deems necessary and appropriate in the public interest and for the protection of investors. No previous application has been made for the relief sought herein.

/s/ JOSEPH O. BARTON.

(Sworn to the 27th day of August 1956.)

(Seal)

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**ORDER TO SHOW CAUSE AND TEMPORARY
RESTRAINING ORDER**

[SAME TITLE.]

On motion of the plaintiff and upon the complaint herein and the sworn affidavit of Joseph O. Barton, and it appearing, satisfactorily, that the defendant herein, pending determination of this action, will, unless enjoined, continue to make use of the mails and the means and instrumentalities of interstate commerce to effect transactions in, and to induce and attempt to induce the investing public and others to purchase and sell securities (other than exempted securities, commercial papers, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange while and at a time his aggregate indebtedness to all other persons exceeds two thousand (2,000) per centum of his net capital, it is hereby

Order to Show Cause

ORDERED that, the defendant show cause at 10 o'clock in the morning of September 4th, 1956, to this Court, U. S. Court House, Room 506, Foley Square, City, County and State of New York, or as soon thereafter as counsel can be heard, why a preliminary injunction pursuant to F. R. C. P. 65 should not be granted for the relief sought by the plaintiff herein, and that service of this order shall be effected

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upon the defendant herein on or before August 29, 1956.

On the motion of the plaintiff and upon the complaint herein and the sworn affidavit, it further satisfactorily appearing that unless the defendant is restrained from continuing the acts alleged in the complaint, immediate and irreparable injuries, loss and damage may result to members of the investing public and to other brokers and dealers in securities, in that such persons may be induced by the defendant to engage in transactions of purchase or sale of securities with defendant, a sole proprietorship as dealer, or through him as a broker, and to pay over to the defendant for the purpose of such transaction moneys and securities without those safeguards with respect to the financial responsibility of the defendant M. J. Shuck d/b/a M. J. Shuck Co. provided for by Section 15(c)(3) of the Securities Exchange Act of 1934 and the rules promulgated by the Commission thereunder to provide safeguards with respect to the financial responsibility of brokers and dealers, it is hereby

ORDERED that, pending the determination of the motion for preliminary injunction herein, the defendant, his agents, servants, employees, attorneys and assigns and each of them, be and they are hereby restrained from, directly or indirectly, making use of the mails or of the means and instrumentalities of interstate commerce to effect transactions in, or to induce or to attempt to induce the purchase or sale of securities (other than an exempted security, commercial

Memorandum of Commission

paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange at a time when his aggregate indebtedness to all other persons exceeds two thousand (2,000) per centum of his net capital. This restraining order shall expire 10 days after its filing in the office of the clerk of this Court.

ARCHIE O. DAWSON,
U. S. D. J.

Dated: 8/28/56.

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**MEMORANDUM OF SECURITIES AND EXCHANGE
COMMISSION**

[SAME TITLE.]

I—VIOLATION OF RULE X-15C3-1

Pursuant to Section 15(c)(3) of the Securities Exchange Act of 1934 (15 U. S. C. 78o(c)(3)) to provide safeguards with respect to the financial responsibility of brokers and dealers and to protect investors, the Commission promulgated Rule X-15C3-1 explicitly prohibiting any broker or dealer from engaging in business when his aggregate indebtedness to all other persons exceeds 2,000 per centum of his net capital. The Commission prescribed said Rule as necessary and appropriate in the public interest as a safeguard against insolvency of brokers and dealers. In the matter of National Association of Securities Dealers, Inc., 12 SEC, Report 322, October 28, 1942. The defendant broker M. J. Shuck doing business as M. J. Shuck Co. is engaging in business in open violation of said Rule.

Memorandum of Commission

II—NECESSITY OF INJUNCTION

1. In the present proceedings we are concerned with recent Acts of Congress establishing an important policy for

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the protection of the public in the sale and purchase of securities. Not only the language of the statute but the fundamental purposes of the Acts can only be effected by a definite decree of the Court which adjudicates the illegality of the practice in the past and enjoins the defendant herein from repetition of said illegal act in the future. Injunction in such matters is necessarily an important feature of the legislation for the protection of the public in the future. SEC v. Lawson, 24 F. Supp. 360 (D. Md., 1938).

2. The standards of the public interest not the requirements of private litigation measure the propriety and need for injunctive relief in these cases. Hecht Co. v. Bowles, Price Administrator, 321 U. S. 321 (1944).

3. Courts will not and do not grant injunctions to prevent that which is unnecessary. R. J. Koeppe and Co., et al. v. SEC, 95 F. (2) 550 (C. A. 7, 1938). But in the instant case, the necessity of an injunction is obvious. The defendant is engaging in the purchase and sale of securities while in direct violation of the minimum requirements of financial responsibility prescribed by the Commission for the protection of investors against financially unsafe brokers and dealers. Such a violation creates a serious danger to the investor's fund as well as to public confidence.

4. Along with its power to hear the case, the Court's power to grant injunctive relief survives discontinuance of the illegal conduct. United States v. W. T. Grant Co., 73 S. Ct. 894 (1953).

Memorandum of Commission

5. The purpose of an injunction is to prevent future violations. *United States v. W. T. Grant, supra.*

6. The necessary determination (to satisfy the Court of the need for injunctive relief) is that there exists some cognizable danger of recurrent violation, something more

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than the mere possibility which serves to keep the case alive.

United States v. Grant, supra. To be considered are the bona fides of the expressed intent to comply, the effectiveness of the discontinuance and, in some cases, the character of the past violations. It is to be noted that the violation in the instant case can only be ascertained by a physical inspection of the books and records of the defendant and thus repetition of the violation of the Act by the defendant is more than a mere possibility in view of the latitude allowed the defendant by the very nature of the enforcement process.

PAUL WINDELS, JR.,
Regional Administrator.

WILLIAM D. MORAN,
Chief Enforcement Attorney.

JOHN J. DEVANEY, JR.,
Attorney.

EILEEN E. EVERS,
Attorney.

NEW YORK REGIONAL OFFICE
SECURITIES AND EXCHANGE COMMISSION,
Office and Post Office Address:
225 Broadway, Borough of Manhattan,
City of New York 7, New York.

AFFIDAVIT OF MILTON J. SHUCK

[SAME TITLE.]

STATE OF NEW YORK,
CITY AND COUNTY OF NEW YORK, } ss. :

MILTON J. SHUCK, being duly sworn, deposes and says:

That he makes this affidavit in opposition to a motion for a temporary restraining order and preliminary injunction.

The grounds upon which the opposition is based are fully set forth hereafter.

As to the procedural steps taken by the plaintiff the facts are:

In May of this year the plaintiff ordered an investigation of the defendant to determine the existence of any violations under Section 5—(a) and (b)—of the Securities Act of 1933, as amended and in pursuance of which exhaustive and unrestrained examinations have been available to and made by the plaintiff of all the defendant's books and records.

On August 22nd the Commission made a further order amplifying the investigation to include possible violation of Section 17 of the same Act. On August 23rd, 1956 subpoenas were delivered to the manager of my office at 39 Broadway, New York 4, New York, photostatic copies of which are hereto annexed and marked respectively Exhibits "A" and "B".

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The first of the subpoenas marked Exhibit "A" was returnable the same day at 3 o'clock. The matters called for comprised physically 8 or 9 large cartons of data and these were made available the same day about 4:30 in the afternoon, the delay from 3 P.M. to 4:30 P.M. being occasioned only by the impossibility of gathering and delivering the material within the unreasonable time specified in the subpoenas duces tecum. The General Manager was sworn and identified the

Affidavit of Milton J. Shuck

various records. I have been informed that my attorney had asked Mr. John J. Devaney, Jr., who had signed the subpoenas, for leave to comply therewith the next morning and that Mr. Devaney referred said attorney to Mr. William D. Moran, Chief Enforcement Attorney, and that Mr. Moran stated that he was powerless to accommodate my attorney. It is obvious that compliance with the strict letter of the subpoenas did require and did add great inconvenience to me in the conduct of my business.

On the following Monday, August 27th, 1956, and about 11:30 A.M., the hour fixed by conversations between the plaintiff and my attorney, my General Manager in the company of my attorney brought the records called for by Exhibit "B" (subpoena d.t.) and identified the same under oath and concluded the certifications about 12:30 P.M.

While my office and my attorney were thus made busy by the plaintiff without notice, formally or informally, to me or to my attorney and were attending to compliance with plaintiff's every request, plaintiff prepared an affidavit for Mr. Joseph O. Barton to be used on this motion to obtain the order to show cause and temporary restraining order. This was apparently prepared by and at the instance of the four attorneys of record for the plaintiff of whom Mr. John J. Devaney, Jr. and Mr. William D. Moran were two and with whom my attorney was in continuous conversation respecting the aforesaid subpoenas and the pending investigation. This may be said to be unfair and discourteous. This

[260C]

is the first time, according to experience on Wall Street, that a registered broker dealer was not given at least 24 hours to adjust his net capital minimum requirements.

When the subpoenas were served on August 23d, 1956 Mr. Barton was one of the gentlemen representing the plaintiff who came to the office. The others were Mr. James Murray, Mr. Edward Wynne, Mr. Reid, an attorney representing the

Affidavit of Milton J. Shuck

plaintiff, and two or three other gentlemen in plaintiff's employ and at that time Mr. Barton and these gentlemen had free entree to all records and stayed for the most part in my office making examinations and audits until almost 3 o'clock in the afternoon, the very hour the subpoenaed records were due at plaintiff's office. The computations were then made from my books which are recited in the affidavit of Mr. Barton. At the time of securing of the instant order to show cause the plaintiff filed the summons and complaint in this matter in behalf of the plaintiff appearing by the said four attorneys of record. The prayer in the complaint is for the temporary and final injunction restraining me from engaging in Interstate Commerce of any kind while my aggregate indebtedness exceeds the limitations imposed by Section 15 (c) (3) of the Securities Exchange Act of 1934 and Rule X-15C3-1 adopted thereunder by the Securities and Exchange Commission.

The plaintiff's summons is dated August 28, 1956, its order to show cause is dated August 28, 1956 and the papers were served upon my office likewise on August 28, 1956. The notice of my being under the minimum requirements thus came to me for the first time on August 28th, 1956.

Mr. Barton has reflected in his affidavit certain figures and computations which indicate the temporary and not wilfull infraction as of August 22d, 1956 but these figures are not altogether correct.

According to my accountant the item marked "3" on page 2 of his affidavit, being my aggregate indebtedness, should

[260D]

be \$244,084.58; the item marked "4" on page 2 should be \$12,204.23; the item marked "5" on page 2 should be \$5,316.73 and item "8" on page 3 should be \$48,849.96. A photostat of my trial balance as at August 22d, 1956 reflecting these figures is attached hereto and marked Exhibit "C". Had

Affidavit of Milton J. Shuck

Mr. Barton or the plaintiff revealed his findings, steps would have been taken at once to meet the minimum requirements.

On August 28th, 1956, at the time that the summons and complaint and order to show cause were served upon my office my accountant was requested to make an audit for a trial balance as at August 28th, 1956 and a photostatic copy thereof marked Exhibit "D" is attached hereto reflecting this condition which showed that the amount needed in order not to exceed 2,000 per cent limitation of my aggregate indebtedness in this branch of my business was \$32,514.00. On the morning of August 29th, 1956 I deposited from other sources of my own a cash sum of \$40,000 which was added to the capital account of this branch of my activities.

A trial balance made as at August 29th, 1956 after said deposit of \$40,000 to the capital account, the net capital surplus was, according to my accountant's report, \$4,283.93 subject to a minor deduction representing the 5 percent (1/20th) of the amount of customers' credit balances.

The primary cause of the momentary deficiency of capital was the gradual lowering of the market price of securities in the long account. As soon as notice of capital deficiency was brought to me I corrected the situation and had it been brought to me earlier I would have made the same correction if the condition existed. There was nothing wilfull or intentionally persistent in my conduct. In fact I drew \$76,500 from my capital account prior to mid-June, 1956, and same did not impair the statutory minimum requirements, as is attested by the fact that a later trial balance delivered to

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and verified by plaintiff was deemed entirely satisfactory.

* * * * *

[260F]

I have not been in violation since the service upon me of the restraining order. This restraining order should be

Affidavit of Milton J. Shuck

vacated. It serves no useful purpose to the plaintiff and does not amplify or extend the direction of the statute nor the plaintiff's rule. Likewise I request the motion for the temporary injunction to be denied. So much for the procedural steps taken by the plaintiff and the full compliance with the statute and the rule since notice of the temporary infraction came to me. The equities in the case are entirely in my favor and should be considered likewise in support of my request to deny the plaintiff's motion.

[260G]

My assets are not now and have never been limited to my business as a broker-dealer in securities. This has been made known to the plaintiff all along. To the best of my knowledge, I have never been without personal assets outside of the broker-dealer securities business sufficient to meet the minimum capital requirements thereof. I have withdrawn from the capital account as aforesaid the sum of \$76,500.00 in the spring of this year, at a time when such withdrawal did not reduce the capital requirements below the legal minimum. Subsequent adverse market fluctuation and not further withdrawals from capital changed the financial condition to reflect the temporary deficiency in minimum capital requirements. Any slight favorable improvement might have avoided the deficiency at the time in question.

I have not made an inventory of all my assets or resources nor do I feel called upon to do so at this time but I do say from knowledge that my assets and resources both before and after the withdrawal of the said \$76,500.00 from my capital account in the broker-dealer business would enable me at all times since the inception of this business to meet the minimum capital requirements or adjust my business so that it would be within the statutory limits. I have arranged moreover, to transfers from my other assets sufficient funds to substantially improve my capital to provide immediate excess from between \$10,000.00 and \$20,000.

Affidavit of Milton J. Shuck

In order that this situation may seldom arise again I have requested my accountant to prepare a simple formula by which my bookkeeping department would have available a daily trial balance. This system will be in practice shortly. As at the close of business on August 31, 1956, (the opening of business on September 4, 1956), the excess over minimum requirements in my capital account is \$5,304.00.

I am entitled to be accorded all the benefits of the statute. I am entitled to the benefit of all doubt. I am entitled to be

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free from the hardship of an injunction. I have demonstrated that there are now and have been at all times adequate safeguards to the public and to my cobrokers with respect to my financial responsibility.

MILTON J. SHUCK.

(Sworn to the 1st day of September, 1956.)

* * * * *

VERIFIED ANSWER

[SAME TITLE.]

FIRST DEFENSE

1. The averments of the first and sixth paragraphs are denied.
2. The averments of the second, third and fourth paragraphs are admitted.
3. The averments of the fifth paragraph are denied, except that the defendant admits that he was at the times mentioned and now is a broker-dealer in securities.

SECOND DEFENSE

4. The complaint fails to state a cause of action upon which relief can be granted.

HARRY D. MENCHER,
Attorney for Defendant,
Office & P. O. Address,
141 Broadway,
New York, N. Y.

**REPLY MEMORANDUM OF SECURITIES AND
EXCHANGE COMMISSION**

[SAME TITLE.]

Counsel for the Securities and Exchange Commission respectfully request the Court's permission to submit the following information in reply to the memorandum of law of the defendant served upon counsel for the Securities and Exchange Commission at 5:19 p.m., September 5, 1956.

Counsel for the Commission, during the oral argument, did not concede that an examination of the defendant's books made by representatives of the Commission on August 31, 1956, disclosed that his aggregate indebtedness was not in excess of the two thousand per centum (2,000%) limit, but pointed out to the Court that there was a serious question of compliance with the Rule in that an item of \$20,000.00 appearing in the capital account of the defendant could, under the Commission's accounting practice, be considered a loan and therefore a liability. To determine whether there was compliance with the net capital rule on August 31, 1956, would require a complete audit of the defendant's books and records and the substantiation of the various items appearing in the defendant's capital account.

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Counsel for the Commission respectfully points out to this Court that defendant's memorandum of law characterizing the examination made of the books and records of the defendant on August 22, 1956, as a "surprise" inspection, is erroneous. In fact, the then counsel for the defendant was advised on December 21, 1955, that an inspection of the defendant's books and records indicated that defendant had an adjusted net capital (deficit) of \$218,254.81 as of November 30, 1955, and defendant personally conferred with staff members of the New York Regional Office of the Securities and Exchange Commission on January 10, 1956, to determine what action M. J. Shuck Co. intended to take to bring its financial condition within the requirements of Rule X-15C3-1.

Reply Memorandum of Commission

Since that date, the defendant, M. J. Shuck Co., has submitted subordination agreements for various monies loaned to him and at no time during this period has defendant ever been advised that his financial position was such as to meet the requirements of the net capital rule. In fact, the defendant, M. J. Shuck Co., has been aware of the necessity for complying with the Rule, and his failure to do so constitutes grounds upon which the Court should issue an injunction.

Counsel for the Securities and Exchange Commission further points out to this Court that prior to August 22, 1956, and during the period August 22, 1956 through August 31, 1956, when the temporary restraining order was in existence and a serious question still remained as to whether or not the monies supplied brought the defendant into compliance with Rule X-15C3-1, said defendant engaged in securi-

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ties transactions, effecting purchases and sales of securities for its customers, and in effecting such transactions used the mails and the means and instrumentalities of interstate commerce.

9-6-56.

PAUL WINDELS, JR.,
Regional Administrator,

WILLIAM D. MORAN,
Chief Enforcement Attorney.

JOHN J. DEVANEY, JR.,
Attorney.

EILEEN E. EVERS,
Attorney.

NEW YORK REGIONAL OFFICE
SECURITIES AND EXCHANGE COMMISSION,
Office and Post Office Address:
225 Broadway,
Borough of Manhattan,
City of New York, N. Y.

MEMORANDUM OPINION

[SAME TITLE.]

The plaintiff, hereafter called the Commission, moved by order to show cause for a preliminary injunction. The order to show cause was made on August 28, 1956, and it stayed the defendant from engaging in the practice sought to be enjoined. The order by its terms expires ten days after its filing in the office of the Clerk of this Court. The filing occurred on August 28, 1956. Argument of the motion was heard on September 4, 1956. Counsel for the defendant was granted until the following day to file his memorandum. The Commission's reply was filed today.

The defendant does not deny the facts charged by the Commission which constitute the violation sought to be restrained. The defendant merely contends he was too speedily hailed to court and urges that he will in the future comply with the Commission's rules. The contention is not supported by the admitted facts and I am not persuaded that the promise of future compliance is buttressed by his past record. It appears from the Commission's affidavits that the conditions complained of were first pointed out to the defendant almost a year ago.

The motion is granted. Settle order.

September 6, 1956.

JOHN F. X. McGOHEY,
U. S. D. J.

**ORDER FOR PROCEEDINGS AND NOTICE OF HEARING
PURSUANT TO SECTIONS 15(b) AND 15A OF THE
SECURITIES EXCHANGE ACT OF 1934**

**UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION**

November 16, 1956.

IN THE MATTER

—of—

MILTON SHUCK, d/b/a M. J.
SHUCK COMPANY,
39 Broadway,
New York, New York.

I

The Commission's public official files disclose that:

- A. Milton Shuck, doing business as M. J. Shuck Company (a sole proprietor), hereinafter referred to as registrant became registered with this Commission February 24, 1955. On October 24, 1956, registrant filed a notice of withdrawal of its registration. Said withdrawal has not yet become effective, and registration is still in effect.
- B. M. J. Shuck Company is a member of the National Association of Securities Dealers, Inc., a national securities association registered pursuant to Section 15 A of the Securities Exchange Act of 1934.

Order for Proceedings and Notice of Hearing

- C. M. J. Shuck Company is temporarily enjoined by decree of United States District Court for the Southern District of New York, entered on September 6, 1956 from engaging in and continuing certain conduct and practices in connection with purchase and sale of securities.

II

Members of the staff have reported to the Commission information obtained as a result of an investigation which tends to show that during the period from approximately August 22, 1956 to approximately September 6, 1956, registrant used the mails and the means and instrumentalities of interstate commerce to effect transactions in and to induce and to attempt to induce the purchase and sale of securities otherwise than on a national securities exchange when the aggregate indebtedness of registrant to all other persons exceeded 2,000 per centum of his net capital.

III

The information reported to the Commission by members of its staff as set forth in Section II hereof, if true, tends to show that registrant violated Section 15(c)(3) of the Securities Exchange Act of 1934 in that registrant made use of the mails and of the means and instrumentalities of interstate commerce to effect transactions in and to induce and to attempt to induce the purchase and sale of securities otherwise than on a national securities exchange, while registrant permitted its aggregate indebtedness to all other persons to

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exceed 2,000 per centum of his net capital in contravention of Rule X-15C3-1 prescribed by the Commission under said Section.

Order for Proceedings and Notice of Hearing

IV

The Commission, having considered the aforesaid information deems it necessary and appropriate in the public interest and for the protection of investors that proceedings be instituted to determine:

- (a) whether the statement set forth in Section II hereof is true;
- (b) whether registrant has wilfully violated Section 15(c) (3) of the Securities Exchange Act of 1934 and Rule X-15C3-1 prescribed under said Section;
- (c) whether, pursuant to Section 15(b) of the Securities Exchange Act of 1934, it is in the public interest to revoke the registration of registrant;
- (d) whether, pursuant to Section 15(b) of the Securities Exchange Act of 1934, pending final determination, it is necessary or appropriate in the public interest or for the protection of investors to suspend the registration of registrant;
- (e) whether, pursuant to Section 15A of the Securities Exchange Act of 1934, it is necessary or appropriate in the public interest or for the protection of investors to suspend for a period not exceeding twelve (12) months or to expel respondent from membership in the National Association of Securities Dealers, Inc.

V

IT IS HEREBY ORDERED that a hearing for the purpose of taking evidence on the questions set forth in Section IV hereof be held at 10 a.m. on the 14th day of January, 1957, in the New York Regional Office of the Securities and Exchange Commission, located at 225 Broadway, New York 7, New York, before James C. Ewell, Hearing Examiner, or

Order for Proceedings and Notice of Hearing

such other Hearing Examiner as the Commission may designate. Upon the completion of the taking of evidence in this matter, the Hearing Examiner shall prepare a recommended decision pursuant to Rule IX(b) of the Rules of Practice, unless such decision is waived.

By the Commission

ORVAL L. DuBOIS
Secretary

(Seal)

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FINDINGS AND OPINION OF THE COMMISSION

(Securities Exchange Act Release No. 5574.)

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C.

[SAME TITLE.]

September 13, 1957

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These proceedings were instituted under Sections 15(b) and 15A(l)(2) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether to revoke the registration as a broker and dealer of Milton J. Shuck, doing business as M. J. Shuck Company ("registrant"), and whether to suspend or expel him from membership in the National Association of Securities Dealers, Inc. ("NASD").¹

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The order for proceedings alleges that during the period from approximately August 22, 1956 to approximately

¹ Section 15(b) of the Exchange Act, as here applicable, provides that we may revoke the registration of a broker or dealer if we find that it is in the public interest and such broker or dealer has willfully violated any provision of the Exchange Act or any rule or regulation thereunder, or is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in any conduct or practice in connection with the purchase or sale of securities.

Section 15A(l)(2) authorizes us to suspend or expel from a national securities association any member thereof who has violated any provision of the Exchange Act or any rule or regulation thereunder if such action is necessary or appropriate in the public interest or for the protection of investors.

Findings and Opinion of Commission

September 6, 1956, registrant effected securities transactions when his aggregate indebtedness exceeded 2,000 per cent of his net capital, in violation of Section 15(c)(3) of the Exchange Act and Rule X-15C3-1 thereunder;² and that he is temporarily enjoined by a decree of the United States District Court for the Southern District of New York entered on September 6, 1956, from engaging in and continuing certain conduct and practices in connection with the purchase and sale of securities.

After appropriate notice, a public hearing was held before a hearing examiner, and registrant and our Division of Trading and Exchanges ("Division") submitted proposed findings and conclusions of law and registrant submitted a supporting brief. The hearing examiner submitted a recommended decision in which he recommended that registrant's registration as a broker and dealer be revoked and that registrant be expelled from the NASD. Registrant filed exceptions to the recommended decision and a brief in support of such exceptions, and the Division filed a brief in reply thereto. Thereafter we heard oral argument. Our findings are based upon an independent review of the record.

* * * * *

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*Injunction and Failure to Comply with
Net Capital Requirements*

On August 28, 1956, a temporary restraining order was issued against registrant by the United States District Court

² Section 15(c)(3) of the Exchange Act prohibits the use of the mails or interstate facilities in securities transactions by a broker or dealer in contravention of our rules prescribed thereunder providing safeguards with respect to the financial responsibility of brokers and dealers. Rule X-15C3-1 provides, as applicable here, that no broker or dealer shall permit his aggregate indebtedness to all other persons to exceed 2,000 per cent of his net capital computed as specified in the rule.

Findings and Opinion of Commission

for the Southern District of New York, on the basis of a complaint filed by us alleging that from approximately August 22, 1956 registrant was engaged, and was about to engage, in acts and practices violative of Section 15(c) (3) of the Exchange Act and Rule X-15C3-1 thereunder, in that registrant was effecting securities transactions in the over-the-counter market through the use of the mails and instrumentalities of interstate commerce while his aggregate

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indebtedness to all other persons exceeded 2,000 per cent of his net capital as computed under the Rule. After hearing argument and receiving legal memoranda from counsel, the District Court on September 6, 1956 issued a memorandum opinion which found that a preliminary injunction should be granted and in which the Court stated:

"The defendant does not deny the facts charged by the Commission which constitute the violation sought to be restrained. The defendant merely contends he was too speedily hailed to court and urges that he will in the future comply with the Commission's rules. The contention is not supported by the admitted facts and I am not persuaded that the promise of future compliance is buttressed by his past record. It appears from the Commission's affidavits that the condition complained of was first pointed out to the defendant almost a year ago."

On September 7, 1956, the Court issued a preliminary injunction against registrant, including in its order the following finding:

"* * * the defendant, M. J. Shuck, individually, and doing business as M. J. Shuck Co., was engaged in and about to engage in acts and practices which constitute a violation of Section 15(c) (3) of the Securi-

Findings and Opinion of Commission

ties Exchange Act of 1934, 15 U. S. C. 78o(c)(3) and * * * unless enjoined, will continue to engage in said acts and practices, * * *."

The Division has additionally urged in this proceeding, and the hearing examiner found, that registrant had willfully violated Section 15(c)(3) of the Exchange Act and Rule X-15C3-1 thereunder. Registrant contends that no such finding of violation can be made in this proceeding because the record herein does not contain evidence that registrant actually effected a securities transaction through the use of the mails or the means of interstate commerce at a time when his net capital position was in violation of Rule X-15C3-1. However, in our opinion it is not necessary in this case for us to reach this question, inasmuch as the existence of the injunction against registrant itself clearly furnishes a statutory basis for revocation of registrant's registration under Section 15(b) of the Exchange Act, provided we find such action to be in the public interest. Accordingly, we turn to a consideration of the question whether revocation is in the public interest.

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Public Interest

Registrant urges that it is not necessary in the public interest to revoke his registration because of the injunction. He contends that there was no evidence in the court proceedings of past violations of the Exchange Act, and the injunction merely bars him from future acts which the Exchange Act and the rules themselves prohibit. He asserts that while on August 22, 1956, there was a deficiency in his net adjusted capital as required by Rule X-15C3-1, as alleged in the complaint in the injunction action, this deficiency was not willful and was made good by a contribution to capital of \$40,300 on August 29, 1956, immediately after he was served with the complaint.

Findings and Opinion of Commission

The record does not substantiate registrant's position.

Registrant's registration as a broker and dealer became effective on February 24, 1955. An analysis of registrant's trial balance as of November 30, 1955, by a member of our staff, disclosed that there was a deficiency of \$220,545 in the adjusted net capital needed to comply with the requirements of Rule X-15C3-1. An analysis of registrant's trial balance as of December 31, 1955 disclosed a deficiency in the adjusted net capital required under the rule of \$262,657.

A large part of these deficiencies resulted from a very substantial short position maintained by registrant with respect to one security. Although our staff discussed the question of compliance with Rule X-15C3-1 with registrant, his accountant and his attorney,³ on a number of occasions during December 1955 and January 1956, it was not until January 18, 1956 that registrant corrected his short position by buying and paying for the shares involved.

However, this did not eliminate entirely registrant's net capital deficiency, since approximately \$46,000 of his net capital represented indebtedness covered by subordination agreements which did not comply with the requirements of

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the rule.⁴ Throughout the period approximately January

³ Registrant's counsel in these proceedings did not represent him at that time.

⁴ Rule X-15C3-1(c)(1) provides that in computing his aggregate indebtedness a broker or dealer may exclude therefrom, among other things, indebtedness which is subordinated to claims of general creditors pursuant to a satisfactory subordination agreement. Rule X-15C3-1(c)(7) defines a satisfactory subordination agreement as one which, among other things, is not subject to cancellation for at least one year. The subordination agreements furnished by registrant did not include such a restriction.

Findings and Opinion of Commission

to June 1956, our representatives sought through a series of conferences and discussions with registrant and his representatives to secure proper subordination agreements and obtain compliance with the net capital rule. These efforts were on the whole unsuccessful.

An analysis of registrant's trial balance as of May 31, 1956 showed a deficiency in the adjusted net capital required under the rule of \$54,000, and a deficiency of approximately \$19,000 even if loans covered by unsatisfactory subordination agreements were excluded from registrant's aggregate indebtedness. An analysis of registrant's trial balance as of June 15, 1956, still showed a deficiency in the required net capital of \$9,700. Satisfactory subordination agreements were not furnished until July 9, 1956.

On August 23, 1956, an analysis of registrant's trial balances as of August 22, 1956, again showed a deficiency in the required net capital under the rule, this time in the amount of \$71,920. This was followed by the temporary restraining order of August 28, 1956 and the preliminary injunction of September 7, 1956, previously noted. Although registrant informed the Court in the injunction proceedings that he had deposited \$40,300 to cure the deficiency, our staff did not agree that this deposit brought registrant into compliance with the rule. It questioned in particular whether a substantial part of the \$40,300 was obtained through a loan and thereby increased registrant's aggregate indebtedness. Registrant and his then counsel had on several occasions represented that registrant would explain the questioned transactions and furnish copies of the underlying documents, but this was never done.

Registrant's actions for the period of almost a year before the entry of the injunction, during which he was informed numerous times of the requirements of and the need to

Findings and Opinion of Commission

comply with the net capital rule, demonstrate at the least a lack of any real concern about the matter, and negative any

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conclusion that the August 22, 1956 deficiency in required net capital was unintentional or inadvertent. And the District Court's memorandum opinion and order, copies of which are a part of the record herein, clearly indicate the Court's opinion that registrant had violated Section 15(c)(3) of the Act in the past and would do so again in the future unless enjoined.

Under all the circumstances, we find that it is in the public interest to revoke registrant's registration as a broker and dealer and not to permit his notice of withdrawal to become effective. Our order of revocation will also have the effect of expelling registrant from membership in the NASD.

Opportunity to Achieve Compliance

Registrant has contended that these proceedings must be dismissed as not in compliance with Section 9(b) of the Administrative Procedure Act of 1946 ("Procedure Act"). That Section provides in pertinent part that, except in cases of willfulness or those in which public interest requires otherwise, no revocation proceedings may be instituted unless prior thereto facts or conduct which may warrant revocation are called to the attention of the registrant in writing and he is accorded an opportunity to demonstrate or achieve compliance with lawful requirements.

We find no merit in this contention. The history of registrant's repeated net capital deficiencies and the numerous discussions concerning them between our staff and registrant and his representatives in our opinion clearly brings the situation within the express exception provided in Section 9(b) of the Procedure Act with respect to cases of willfulness or those in which the public interest requires institution of

Findings and Opinion of Commission

proceedings without further opportunity for compliance.⁵

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Other Matters and Rulings on Exceptions

Registrant has also argued that the hearing examiner's recommended decision is vitiated by the use of material outside the record, contending that there is no evidence in the record to support a reference in the recommended decision to currency obtained by registrant from a safe deposit box. In our opinion the questioned statement is irrelevant to the issues in this case. In any event, our findings and conclusions are based upon an independent review of the record, and we have disregarded the examiner's statement. Accordingly registrant has not been prejudiced.

To whatever extent registrant's exceptions to the recommended decision involve issues which are relevant and material to the decision in this case, we have by our opinion herein already fully ruled upon them. We hereby expressly sustain those exceptions to the extent that they are in accord with the views set forth herein, and we expressly overrule those exceptions to the extent that they are inconsistent with such views.

An appropriate order will issue.

By the Commission (Commissioners Orrick, Patterson, Hastings, and Sargent), Chairman Gadsby not participating.

ORVAL L. DuBOIS

Secretary

⁵ Cf. *Sterling Securities Co.*, Securities Exchange Act Release No. 5527 (1957).

Where, as in the present case, the statutory basis for revocation is the existence of an injunction against a registrant, it is difficult to see what further advance opportunity to achieve compliance would be appropriate. We may also note that during the oral argument in July 1957, almost one year after the issuance of the preliminary injunction, counsel for registrant indicated that the injunction was still in effect, that no action had yet been taken by registrant to obtain vacation of the injunction, and that it was not known whether registrant contemplated such action.

**ORDER REVOKING BROKER-DEALER REGISTRATION
AND NOT PERMITTING WITHDRAWAL TO BECOME
EFFECTIVE**

September 13, 1957

[SAME TITLE.]

Proceedings having been instituted to determine whether pursuant to Section 15(b) of the Securities Exchange Act of 1934 the registration as a broker and dealer of Milton J. Shuck, doing business as M. J. Shuck Company, should be revoked;

A hearing having been held after appropriate notice, proposed findings and conclusions having been submitted, the hearing officer having filed a recommended decision, exceptions thereto and briefs having been filed, and oral argument having been heard;

Registrant having previously filed a notice of withdrawal of registration which has not become effective;

The Commission having this day issued its Findings and Opinion herein; on the basis of said Findings and Opinion

IT IS ORDERED that the registration as a broker and dealer of Milton J. Shuck, doing business as M. J. Shuck Company, be, and it hereby is, revoked, and that his notice of withdrawal from registration be, and it hereby is, not permitted to become effective.

By the Commission.

ORVAL L. DuBOIS
Secretary

BRIEF FOR PETITIONER

UNITED STATES COURT OF APPEALS

DISTRICT OF COLUMBIA CIRCUIT.

MILTON J. SHUCK, doing business as
M. J. SHUCK COMPANY,
Petitioner,

—v.—

SECURITIES AND EXCHANGE
COMMISSION,
Respondent.

No. 14208

PETITION TO REVIEW ORDER OF SECURITIES AND EXCHANGE COMMISSION

MILTON POLLACK,
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CLERK

QUESTIONS PRESENTED

The stipulated questions on this review, approved by order of this Court (Prettyman, C.J.), are as follows:

1. Whether section 9(b) of the Administrative Procedure Act requires that notice of capital deficiency and opportunity to correct be given before the Commission may revoke petitioner's registration on the basis of a preliminary injunction entered by a United States District Court.

2. Assuming that section 9(b) is applicable:

a. Whether notice of capital deficiency with opportunity to correct was given to Shuck, except insofar as the service of the *ex parte* order in the injunctive proceedings in the Southern District of New York constituted notice.

b. Whether, if service of the *ex parte* order constituted notice, Shuck came into compliance the next day and thereafter remained in compliance.

c. Whether there was substantial evidence on which the Commission could find that Shuck's conduct was wilful so as to make applicable the exception for wilfulness under section 9(b) of the Administrative Procedure Act.

d. Whether there was substantial evidence on which the Commission could find that it was in the public interest to revoke Shuck's registration so as to make applicable the exception relating to public interest under section 9(b) of the Administrative Procedure Act.

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3. Whether there was substantial evidence on which the Commission could find that it was in the public interest to revoke Shuck's registration under section 15(b) of the Securities Exchange Act of 1934.

4. Whether the issuance of a temporary injunction under the circumstances of this case furnishes the statutory basis under section 15(b) of the Securities Exchange Act of 1934, for revocation of Shuck's registration.

5. Whether section 15(b) of the Securities Exchange Act of 1934 must be read together with section 9(b) of the Administrative Procedure Act, and if there is any conflict whether the Administrative Procedure Act must govern.

6. Whether Shuck's activities prior to August 22, 1956 could be properly considered by the Commission.

7. Whether the Commission could revoke Shuck's registration without finding a wilful violation of section 15(c)(3) of the Securities Exchange Act of 1934 and Rule X-15C3-1 thereunder.

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UNITED STATES COURT OF APPEALS

DISTRICT OF COLUMBIA CIRCUIT.

MILTON J. SHUCK, doing business as
M. J. SHUCK COMPANY,
Petitioner,

—v.—

SECURITIES AND EXCHANGE
COMMISSION,
Respondent.

No. 14208

JURISDICTION

An order of the Securities and Exchange Commission made on September 13, 1957 revoking petitioner's registration as a broker-dealer comes before this Court on a timely petition for review served and filed on November 12, 1957. Petitioner's right to a review and the jurisdiction of this Court rest on Section 25 of the Securities Exchange Act of 1934, 15 U. S. C. 78y, and Section 10 of the Administrative Procedure Act, 5 U. S. C. 1009.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved herein are set out in the Appendix to this brief.

THE PROCEEDINGS IN THE COMMISSION

On October 19, 1956, petitioner Milton J. Shuck, a broker-dealer registered under the Securities Exchange Act of 1934, gave written notice to the Commission of the withdrawal of his registration. The Commission received this notice on October 24, 1956.

Under the Commission's Rule X-15B-6, this withdrawal became effective thirty days later unless "prior to its effective date the Commission institutes a proceeding pursuant to Section 15(b) to revoke or suspend the registration of such broker or dealer * * *."

The Commission instituted such a proceeding by its order dated November 16, 1956, amended November 30, 1956.

The order for proceedings and notice of hearing recited that the Commission proposed to ascertain whether it was true as reported to it by its staff

"that during the period from approximately August 22, 1956 to approximately September 6, 1956, registrant [petitioner] used the mails and the means and instrumentalities of interstate commerce to effect transactions in and to induce and to attempt to induce the purchase and sale of securities otherwise than on a national securities exchange when the aggregate indebtedness of registrant to all other persons exceeded 2,000 per centum of his net capital."

The order for proceedings recited that, if true, the staff report "tends to show that registrant violated Section 15(c) (3) of the Securities Exchange Act of 1934" [15 U. S. C. 78o (c) (3)] and "Rule X-15C3-1 prescribed under said Section."

The Commission directed that evidence be taken to determine whether during the period from approximately August 22, 1956 to approximately September 6, 1956 petitioner had wilfully violated the net capital requirements rule, whether it is in the public interest to revoke his registration or pending final determination to suspend his registration and whether to suspend for not more than 12 months or expel petitioner from membership in the National Association of Securities Dealers, Inc. (hereafter "NASD").

A public hearing was held on January 14 and 15, 1957 before a hearing examiner designated by the Commission who submitted a recommended decision on May 7, 1957 in which he recommended revocation of petitioner's registration and that petitioner be expelled from the NASD.

Petitioner filed exceptions to the recommended decision of the Hearing Examiner, and these were argued orally before the Commission on July 10, 1957. The Commission filed its findings, opinion, and order on September 13, 1957 revoking petitioner's registration and refusing to permit his notice of withdrawal from registration to become effective.

A petition for review of this order was timely served and filed in this Court on November 12, 1957. On a prehearing conference, the issues were stipulated in writing and a schedule was agreed on for filing briefs and the joint appendix; these stipulations were approved by this Court's order dated January, 29, 1958.

STATEMENT OF CASE

The Commission notified petitioner that it was instituting proceedings to determine whether during the period August 22, 1956 to September 6, 1956, approximately, the petitioner's capital with which to do business was inadequate.

The petitioner was never duly notified by the Commission that it was proceeding against him for any capital deficiency during any period prior to August 22, 1956 and no prior period is embraced in the Commission's order for proceedings.

Nonetheless the Commission now relies heavily on events outside the period specified by its own order for proceedings as basis for the revocation order on review. For chronological completeness we shall deal in this statement, first, with the previous period and then, with the period made issuable by the order for proceedings as well as the period thereafter.

a) Events preceding August 22, 1956.

Petitioner asserts that the events preceding August 22, 1956 are no part of this case, because they are not embraced within the Commission's order instituting this proceeding and because the Commission did not give the written notice and opportunity to correct any claimed deficiency of capital

which are mandated by Section 9(b) of the Administrative Procedure Act to make these prior events legally significant.

The interest of the Commission's staff in whether petitioner was maintaining the minimum capital which is required of a broker-dealer dates from the end of 1955. In December petitioner was orally advised that inspections of his records made by the Commission's New York office in November and December showed an adjusted net capital deficit (Tr. 172, 194, 199, 202-3). These deficits allegedly had to do with petitioner's short position on certain stock (Tr. 205) and with certain indebtedness as to which subordination agreements were needed (Tr. 172, 207; see also Tr. 223-4).

Petitioner's short position was corrected by January 18, 1956 (Tr. 206, 223).

Petitioner obtained written subordination agreements by January 1956 at the latest (Tr. 172-3, 207-8). There then ensued negotiations between his attorney and representatives of the Commission's staff about the precise form of wording of these agreements to bring them into compliance with the staff's interpretation of the Commission's rules (Tr. 172-5, 209-10). On July 9, 1956, written agreements modified to the satisfaction of the staff were filed (Tr. 210).

The Commission never gave petitioner the written notice required by statute that any of his transactions before August 22, 1956, the earliest date mentioned in its order of November 16, 1956, violated the Securities Exchange Act or any of the Commission's rules. It is not uncommon for market fluctuations or other circumstances to result in relatively temporary capital deficiencies and the Commission's staff in many such cases negotiates for restoration of sufficiency. Such staff negotiation does not ground formal proceedings against a broker-dealer for a capital deficiency and the statute makes this clear. Administrative Procedure Act § 9(b), 5 U. S. C. 1008(b).

b) August 22-26, 1956.

On August 23, 1956, Joseph Barton, a securities investigator on the Commission's staff, visited petitioner's office (Tr. 16). Although he examined the books and found, according to his computations, a capital deficiency as of August 22 (Tr. 19), he gave no written notice to petitioner to correct this deficiency (Tr. 34-6).

The same day, subpoenas were served at petitioner's office (Tr. 65; cf. Tr. 117; see, in Ex. 7, Exs. A and B attached to affidavit of Milton J. Shuck, sworn to Sep. 1, 1956), and his books were taken into and remained in the staff's possession for some time (Tr. 65).

No written notice of any capital deficiency was given during this time.

c) The injunction proceedings: Aug. 27-Sep. 7, 1956.

The first writing ever served upon petitioner in this connection was not a notice of deficiency or warning addressed to him (Tr. 72), but was a summons and complaint and an order to show cause and temporary restraining order in an action, *Securities and Exchange Commission v. Shuck*, Civ. No. 112-267, which the staff instituted against him on August 28, 1956 in the United States Court for the Southern District of New York (Tr. 108; Ex. 7). The order to show cause was obtained on the basis of an affidavit of Barton, the securities investigator, sworn to on Aug. 27 (Ex. 7). Petitioner was served on August 28.

The temporary restraining order (in Ex. 7) forbade petitioner to conduct business while his capital was below the minimum, and there is no evidence in the record showing that he did conduct any business during the ten days —August 28 to September 7— of the order's pendency.

On August 29 petitioner made a deposit of \$40,300 of his own money to the general purposes of M. J. Shuck Co. (Tr. 84). This deposit rectified the capital deficiency, so that on

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August 31, when Bernard D. Pollakoff, another securities investigator on the Commission's staff, visited petitioner's office and took off a trial balance as of August 30, he found an excess of capital over the Commission's requirements (Tr. 75).

Although on the hearing before the Examiner the staff attempted to question this capital deposit, they were unable to establish that it was in any way deficient or improper, and the Commission's opinion does not find that it is.

On September 4 there was a hearing before Judge McGohey in the New York District Court on the motion for a temporary injunction. The Commission's attorney proceeded before the judge on papers that reflected petitioner's capital situation as of August 22 (Tr. 124-5); he did not think it necessary to call to the Court's attention the correction on August 29th in petitioner's capital situation (Tr. 125).

Judge McGohey granted the Commission's motion for a temporary injunction with a memorandum opinion on September 6, 1956 (in Ex. 7).

The temporary injunction itself was signed on September 7 (Ex. 6). Its ordering paragraph, which is similar to the ordering paragraph of the temporary restraining order, reads:

"ORDERED that the defendant, M. J. Schuck, individually, and doing business as M. J. Schuck Co., his agents, servants, employees, attorneys and assigns, and each of them, be and they are preliminarily enjoined from, until further order of this Court, directly or indirectly, making use of the mails or of any means or instrumentalities of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of securities (other than exempted security, or commercial paper, bankers' acceptance or commercial bills) otherwise than on a national securities exchange while and at a time when his aggregate indebtedness to all other persons exceeds two thousand (2,000) per centum of his net capital."

It in effect forbade petitioner to make use of the means of interstate commerce to effect securities transactions whenever his capital did not meet the Commission's minimum requirements.

d) September 8-November 16, 1956.

From September 14 to November 16 petitioner submitted weekly balance sheets to the Commission's New York office which showed that his capital position was in compliance with the Commission's requirements (Tr. 63). These reports covered the period from September 6 on (Tr. 64).^{*} The staff at the hearing were unable to develop any deficiencies in these reports and the Commission's opinion does not find that there were any.

Petitioner's notice of withdrawal as a broker-dealer was dated October 19, 1956 (Tr. 42); his last report was filed with the New York office on November 16 (Tr. 63).

All creditors were paid and petitioner has no liabilities to his customers (Tr. 216).

THE COMMISSION'S OPINION

Since the Commission recites that it made an independent review of the record, it is unnecessary to examine the recommended decision of the Hearing Examiner.

The Commission ascribed prime importance to the issuance of the temporary restraining order in the United States Court for the Southern District of New York on the Commission's own complaint, and the subsequent issuance of a temporary injunction. The Commission held that "the existence of the injunction against registrant itself clearly furnishes a statutory basis for revocation of registrant's registration

^{*} There was no report from August 22 to September 6 because petitioner's books had been subpoenaed by the staff and remained in their possession for some time (Tr. 65).

under Section 15(b) of the Exchange Act, provided we find such action to be in the public interest," as that section requires.

The Commission did not find nor does the record contain any evidence that registrant had actually effected any securities transactions through the use of the mails or the means of interstate commerce at a time when his net capital position was in violation of Rule X-15C3-1.

The Commission held that it was in the public interest to revoke petitioner's registration. In reaching this conclusion, it relied on conversations and negotiations which took place before August 1956; these were unaccompanied by any written notice to petitioner that he was violating the Commission's requirements, and the petitioner was not given the requisite written opportunity to comply with any Commission requirement.

The Commission stated:

"Registrant's actions for the period of almost a year before the entry of the injunction, during which he was informed numerous times of the requirements of and the need to comply with the net capital rule, demonstrate at the least a lack of any real concern about the matter, and negative any conclusion that the August 22, 1956 deficiency in required net capital was unintentional or inadvertent. And the District Court's memorandum opinion and order, copies of which are a part of the record herein, clearly indicate the Court's opinion that registrant had violated Section 15(c) (3) of the Act in the past and would do so again in the future unless enjoined."

The Commission rejected petitioner's contention that it may not revoke a license unless it has complied with Section 9(b) of the Administrative Procedure Act, 5 U. S. C. 1008(b), by giving written notice to petitioner of any non-compliance on which the Commission intended to stand and according him an opportunity to achieve compliance. The Commission said (Opinion n. 5) that where "the statutory basis for revo-

cation is the existence of an injunction against a registrant, it is difficult to see what further advance opportunity to achieve compliance would be appropriate." The Commission ruled that this is a case of wilfulness and that the public interest justified institution of proceedings without opportunity for compliance afforded by statute.

Petitioner's registration was accordingly revoked and his voluntary withdrawal from registration was not permitted to become effective. As a concomitant thereof, he was expelled from membership in the NASD.

POINTS ON APPEAL

I. Section 9(b) of the Administrative Procedure Act is applicable and the Commission did not comply with it. The revocation of petitioner's registration is therefore unlawful.

II. Section 15(b) of the Securities Exchange Act does not justify the revocation of petitioner's registration.

SUMMARY OF PETITIONER'S ARGUMENT

Section 9(b) of the Administrative Procedure Act, 5 U. S. C. 1008(b), conditions the lawfulness of the Commission's revocation of a broker-dealer's registration upon its first giving the broker-dealer (1) written notice of facts and conduct which may warrant revocation and (2) a written opportunity to achieve compliance with the Commission's requirements.

The Commission did not comply with these requirements, and its revocation of petitioner's registration is therefore unlawful. If the proof shows that petitioner violated any of the Commission's net capital regulations, it shows only a single capital deficiency on August 22, 1956. Petitioner received no written notice of this violation, except insofar as the service upon him on August 28, 1956, of a summons and complaint and a temporary restraining order in the New York District Court action, *Securities and Exchange Commission v. Shuck*, can be said to constitute written notice. Petitioner corrected the violation on the next day, and thereafter at all times remained in compliance with the Commission's net capital regulations.

There are only two exceptions to the statutory requirement of prior written notice: "cases of willfulness [and] those in which public health, interest, or safety requires" that no written notice be given. As matter of law, on this record, these exceptions do not apply to petitioner.

The legislative history of these exceptions shows that Congress intended them to be applicable only where the "facts fully and fairly warrant" their application to "manifest" wilfulness and, in the case of the public interest, to situations requiring "immediate action irrespective of the equities or injuries to the licensee."

The Commission did not establish that petitioner wilfully violated the Commission's net capital requirements; at most it showed that from time to time petitioner had discussions with the Commission's staff about the interpretation of the Commission's complicated net capital rule.

The Commission also did not establish that the public interest required short cutting the written notice requirements of the Administrative Procedure Act. The evidence shows nothing about petitioner's conduct of business during August justifying precipitate action. There was no more public interest affected after August 22 than there had been earlier. Indeed, the public interest was not affected at all after August 22.

The Commission has in effect attempted to import a third exception into Section 9(b) of the Administrative Procedure Act, since it takes the view that Section 15(b) of the Securities Exchange Act, 15 U. S. C. 78o(b), authorizes it to revoke a registration when a broker-dealer is temporarily enjoined from engaging in "any conduct or practice in connection with the purchase or sale of any security," if it finds that it is in the public interest to do so, and it has so found.

But the law does not afford the Commission any such exception. There is no substantial evidence to support the Commission's finding in this case of need to protect the public interest.

The injunction on which the Commission relies was not such an adjudication on the merits against petitioner as to ground a revocation proceeding; no finding of an existing violation was made; the injunction purported to restrain petitioner in the future whenever his capital did not meet the Commission's minimum requirements. It was an instruction not to do business in the future if a capital deficiency should thereafter occur. The record is clear that there was no subsequent capital deficiency.

Since the advent of the Administrative Procedure Act, injunctions can no longer do double duty and make automatic a license revocation—unless they are accompanied by the written notice of deficiency and opportunity to correct required by Section 9(b), subject only to the two exceptions contained therein. Section 15(b) of the Securities Exchange Act does not abridge the substantive rights conferred by Section 9(b) of the Administrative Procedure Act. *Pan-*

Atlantic Steamship Corp. v. Atlantic Coast Line R.R., 353 U. S. 436 (1957).

The Commission made the temporary injunction do double duty here. This does indirectly what Section 9(b) of the Administrative Procedure Act prevents the Commission from doing directly. Its order revoking petitioner's registration is unlawful.

POINT I

SECTION 9(b) OF THE ADMINISTRATIVE PROCEDURE ACT IS APPLICABLE AND THE COMMISSION DID NOT COMPLY WITH IT. THE REVOCATION OF PETITIONER'S REGISTRATION IS THEREFORE UNLAWFUL.

Section 15(b) of the Securities and Exchange Act of 1934, 15 U. S. C. 78o(b), requires "appropriate notice and opportunity for hearing" before the registration of a broker-dealer may be revoked. This proceeding, therefore, is one that calls into play the provisions of Section 5 of the Administrative Procedure Act, 5 U. S. C. 1004, as a "case of adjudication required by statute to be determined on the record after opportunity for an agency hearing." Thus, Section 9(b) of the Act, 5 U. S. C. 1008(b), which imposes certain duties upon the Commission "prior to institution of agency proceedings" leading to the revocation of a registration, is applicable.

Section 9(b) of the Administrative Procedure Act provides:

"Except in cases of willfulness or those in which public health, interest, or safety requires otherwise, no withdrawal, suspension, revocation, or annulment of any license shall be lawful unless, prior to the institution of agency proceedings therefor, facts or conduct which may warrant such action shall have been called to the attention of the licensee by the agency in writing and the licensee shall have been accorded opportunity to demonstrate or achieve compliance with all lawful requirements."

In other words, this Section imposes, as conditions precedent to the revocation of a registration, the following requirements:

1. Written notice to the registrant of facts or conduct which may warrant revocation.
2. Opportunity to the registrant to demonstrate or achieve compliance with all lawful requirements.

There are two exceptions to the command of this Section:

1. A case of wilfulness on the part of the registrant.
2. A case where the public health, interest or safety requires that written notice and opportunity for compliance be omitted.

Legislative history of Section 9(b).

The Congress which passed the Administrative Procedure Act intended that the requirements of Section 9(b), which then Attorney General Clark said codified "the best existing law and practice," Sen. Doc. No. 248, 79th Cong., 2d Sess. 229, 413 (1946) (hereafter cited as "Legislative History"), should be bypassed only for strong and compelling reasons. Sen. Rep. No. 752, 79th Cong. 1st Sess. (1945), reprinted in Legislative History 211-2, commenting on Section 9(b), said:

"The exceptions to the second sentence, regarding revocations, apply only where the demonstrable facts fully and fairly warrant the application of the exceptions. Willfulness, must be manifest. The same is true of 'public health, interest or safety.' The standard of 'public * * * interest' means a situation requiring immediate action irrespective of the equities or injuries to the licensee, but the term does not confer upon agencies an arbitrary discretion to ignore the requirement of notice and an opportunity to demonstrate compliance."

Similar language appears in H. R. Rep. No. 1980, 79th Cong., 2d Sess. (1946), reprinted in Legislative History 275.

Analyzing Section 9(b) during the course of debate in the House of Representatives, Representative Walter said, Legislative History 368:

"It requires agencies to determine promptly all applications for licenses, [and] prohibits them from withdrawing a license without first giving the licensee notice and an opportunity to achieve compliance except in cases of obvious willfulness or emergency * * *.

These special provisions are necessary because of the very severe consequences of the conferring of licensing authority upon administrative agencies. * * * The purpose of this section is to remove the threat of disastrous, arbitrary and irremediable administrative action."

Since the above is the interpretation which Congress put upon the bill which became the Administrative Procedure Act, it is of no significance that earlier forms of the bill, e.g., the Senate Judiciary Committee Print of June 1945, Legislative History 11, 34-5, would have made the exception to Section 9(b) applicable to cases of "clearly demonstrated willfulness" and those in which the public interest "manifestly required" no written notice and opportunity to achieve compliance. The words "clearly demonstrated" and "manifestly" were doubtless dropped because they were unnecessary and might create confusion, since there was a burden of proof provision elsewhere in the bill (it is now Section 7(c) of the Act, 5 U. S. C. 1006 (c)).*

**The Commission did not comply with Section 9(b)
of the Administrative Procedure Act.**

The Commission's order initiating revocation proceedings fixed the time of petitioner's alleged violations "from ap-

* The Commission has heretofore misunderstood this legislative history in *Sterling Securities Co.*, Securities Exchange Act Release No. 5527 n. 4 (1957), which the Commission has cited in the course of its opinion in the case at bar (n. 5) in overriding the statutory notice requirement because of alleged wilfulness and requisite public interest.

proximately August 22, 1956 to approximately September 6, 1956 * * *."

The Assistant Regional Administrator of the New York Regional office of the Commission made the following stipulations on the hearing:

"I hereby stipulate on behalf of the Staff that no written notice was given to Milton J. Shuck doing business as M. J. Shuck & Co., with respect to a violation of rule X15-C(3)(1) for the period mentioned in the Commission's order.

* * *

"I will stipulate that no letter from this office was sent to Mr. Shuck or M. J. Shuck & Co. pointing out these violations of law." (Tr. 72.)

"I will stipulate, sir, that there was no written communication given to Shuck. By that I mean a letter from this office or any other office of the Commission, to my knowledge, in which we stated, among other things, that he was not in compliance of 15-C(3)(1)." (Tr. 176.)

The Assistant Regional Administrator, however, made this one reservation:

"I am only reserving this, counsel, that Mr. Shuck was advised in writing upon the receipt of a summons and complaint of these violations of law which is and could be construed as a written notice. Now, whether it is a written notice coming within the purview of what you have in mind, I don't know." (Tr. 73-4)

This reservation refers to the service upon petitioner on August 28 of the ex parte temporary restraining order and complaint in the New York District Court action. The effect of the service of these papers is discussed below in Point II.

The exceptions to Section 9(b) of the Administrative Procedure Act are not applicable.

The record is devoid of substantial evidence to justify forcing this case into the mold of "willfulness" or one "in which public health, interest, or safety requires" that proceedings be instituted without notice.

a) *No wilfulness is involved.*

The Commission has held:

"The history of registrant's repeated net capital deficiencies and the numerous discussions concerning them between our staff and registrant and his representatives in our opinion clearly brings the situation within the express exception provided in Section 9(b) of the Procedure Act with respect to cases of willfulness * * *."

There is no justification for treating petitioner as a wilful violator of the capital requirement rule. "Willfulness must be manifest." It is not only not manifest here, it is non-existent.

Petitioner's alleged wilfulness is based upon the allegations that net capital deficiencies were found in examinations of his books conducted from and after November 1955. In December of that year, following an examination, he was *orally* advised of an adjusted net capital deficit (Tr. 172, 194, 199, 202-3). These deficits were apparently based on two grounds: petitioner's alleged short position on certain stock (Tr. 205) and his indebtedness as to which subordination agreements were needed (Tr. 172, 207; see also Tr. 223-4).

As to the alleged short position, that was corrected by January 18, 1956 (Tr. 206, 223), and that is all there is to that.

As to the subordination agreements, petitioner obtained written agreements by January 1956 at the latest (Tr. 172-3, 207-8). These agreements, however, did not meet with the approval of the staff for one reason or another relating to form or wording. Negotiations ensued between petitioner's then attorney and representatives of the Commission's staff about the precise form and wording of these agreements to bring them into compliance with the staff's interpretation of the Commission's rules (Tr. 172-4, 209-10). On July 9, 1956 written agreements modified to the satisfaction of the Staff were filed (Tr. 210).

Whether or not a violation of Rule X-15C3-1 existed before July 1956 by reason of the inadequacy of the form of the original subordination agreements was not in issue under the Commission's order for proceedings. Indeed, any violation outside the period from August 22 to September 6, 1956, is outside the scope of the Commission's order for proceedings.

The Commission is clearly wrong in finding wilfulness based on alleged deficiencies before August 22, 1956, which were discussed over a long period by the petitioner with the staff without any suggestion of a crackdown by reason thereof. These long discussions between petitioner and the staff resulted in compliance with the precise requirements for subordination agreements, a technical subject on which the Commission's requirements by their very nature cannot be pellucid.* If respondent were wilful, he would not on July 2, 1956 have deposited \$15,000 of his own money to his firm's account (Tr. 218-9) to increase its capital to bring it into compliance with computations made by the staff that ignored the subordination agreements (Tr. 211-2, 217-8). No suggestion of wilful violation emanated either from the staff or the Commission at any time prior to the hearing before the Examiner. The order for proceedings records information supplied by the staff to the Commission as a basis for a proceeding, but there is no mention therein of wilfulness by the petitioner.

But we do not rely solely on these arguments. The inescapable fact is that throughout the period from December 1955 to August 1956 the staff never gave *written* notice to petitioner that he was not in compliance with the minimum capital requirement. That was the sure and proper way, if the staff thought petitioner was evasive or dilatory in his compliance, to bring him up short and lay the requisite groundwork for disciplining him. The Commission and its staff did no such thing. The only admissible conclusion must be that peti-

* The complexity of the net capital rule is apparent from its length alone, covering almost 5 pages in the Appendix hereto.

tioner's alleged non-compliance before August 1956 was not wilful (if indeed he was even out of compliance) and that it was not deemed wilful at the time the Commission entered its orders in the instant proceeding.

The contentions relating to petitioner during the period from November 1955 to July 9, 1956 were plainly after-thoughts and were made late in the hearing and only after cross-examination brought a realization to the staff that its failure to comply with the written notice requirements of the Administrative Procedure Act was a substantive legislative barrier to the revocation of petitioner's registration. The Commission committed legal error by utilizing for its findings and opinion the matters prior to August 1956; these are matters which Section 9(b) of the Administrative Procedure Act renders legally incompetent and immaterial in a revocation proceeding in the absence of written notice.

b) No public interest requirement is involved.

The Commission held:

"The history of registrant's repeated net capital deficiencies and the numerous discussions concerning them between our staff and registrant and his representatives in our opinion clearly brings the situation within the express exception provided in Section 9(b) of the Procedure Act with respect to cases * * * in which the public interest requires institution of proceedings without further opportunity for compliance."

The Commission bases its conclusion with regard to public interest on the same allegations on which it finds that petitioner acted wilfully. These allegations have been analyzed above and shown to be wanting insofar as wilfulness is concerned. They are just as wanting with regard to urgency of the public interest.

The legislative history of § 9(b) of the Administrative Procedure Act shows that Congress understood that "public interest" as used in the Act referred to a pressing situation that required "immediate action irrespective of the equities or injuries to the licensee * * *."

No such pressing necessity for precipitate action has been shown or found. In view of the Commission's own contentions that petitioner was consistently violating the net capital requirement from November 1955, and in the absence of any showing that the situation in August 1956 was more fraught with peril to the investing public than it had been for the previous half year, there is no substantial evidence—there is no evidence—to bring this case within the public interest exception of Section 9(b) of the Administrative Procedure Act. The Commission did not prove the existence of any public need to skip notice and opportunity to comply in order to take immediate action irrespective of the equities or injury to the licensee.

- c) *Petitioner achieved compliance
one day after receiving notice
of capital deficiency.*

For the purposes of this discussion, it is assumed that the service of the papers in the District Court action on petitioner on August 28, 1956 constituted written notice of capital deficiency within the meaning of Section 9(b) of the Administrative Procedure Act. It then became incumbent upon the Commission to afford petitioner an opportunity to achieve compliance with the net capital requirement. Similarly, it became incumbent upon petitioner to achieve this compliance.

Since the statute does not prescribe the time within which this opportunity is to be afforded, on general principles a reasonable time would have to be afforded. It is not necessary to discuss the outer limits of a reasonable time in this case, since the evidence makes clear that petitioner rectified any capital deficiency within twenty-four hours.

On August 31, 1956 Bernard B. Pollakoff, a securities investigator on the staff of the Commission, visited petitioner's offices and took off a trial balance as of August 30 (Tr. 75). His examination showed an excess of capital over the Commission's requirements (*ibid*). This excess resulted

from a deposit of \$40,300 which petitioner had made on August 29 to the general purposes of the M. J. Shuck Co., and Mr. Pollakoff was satisfied of this (Tr. 84).

Mr. Pollakoff admitted he had nothing to do with the case after August 31 (Tr. 94). On the hearing, however, he chose to cavil at some of the items in petitioner's books as of August 30, even though the entries were fair on their face (Tr. 75, 85), and the burden was not on petitioner to justify them.

One item was a profit resulting from transactions with the stock of Midrim Mining Co. on August 21 and 22. The significance of this is not apparent, and Mr. Pollakoff did not think enough about it at the time to ask for further information (Tr. 76). At the hearing he was forced to admit that he had no information that would lead him to question the genuineness of the transaction (Tr. 86).

The same may be said about Mr. Pollakoff's idea that some \$83,000 of customers' debit balances were governed by Regulation T (Tr. 79); this was not pursued, and proof is absent that petitioner's records carried this money improperly.

Another item was the deposit of checks totaling \$40,300 to petitioner's capital account in his firm (Tr. 76). Although this money was legal tender and admittedly credited to the general purposes of the firm (Tr. 84), the staff on the hearing proceeded to treat this money for one reason or another as suspect, so that they could continue to treat petitioner as if he were not in compliance.

Mr. Pollakoff's cross-examination about this \$40,300, particularly \$20,000 of it derived from certain oil deals with one Barrison, evaporated any weight for his impromptu trial opinions. He finally had to admit that he knew nothing about the subjects on which he had proffered opinions in his testimony. The Barrison deal involved a production lien and oil royalty payments, subjects outside Mr. Pollakoff's knowledge, but that did not prevent him from expressing the unsupported suggestion that the \$20,000 was not properly

capital (Tr. 161-5). The rest of the money deposited in the bank was a social outcast in the eyes of this witness because it did not have a pedigree: petitioner said it was money "he had accumulated over a period of time without otherwise disclosing where it came from" (Tr. 79).

It will, however, serve no useful purpose to run to the ground the factual deficiencies in the proof, substantial though they are, since again the inescapable fact is that on August 31 there was a way to make petitioner comply with the capital requirements as the staff understood them or take the consequences—by serving written notice on him of a deficiency. Moreover, since petitioner was already under a temporary restraining order of the District Court, the staff had the remedy of contempt if it could show that petitioner's capital was below the minimum and that he had effected transactions in securities under those circumstances. The staff did neither.

Viewed in the light of the requirements of the Administrative Procedure Act, the Commission's treatment of petitioner's compliance on August 29 is legally unsatisfactory. The Commission wrote:

"On August 23, 1956, an analysis of registrant's trial balance as of August 22, 1956, again showed a deficiency in the required net capital under the rule, this time in the amount of \$71,920. This was followed by the temporary restraining order of August 28, 1956 and the preliminary injunction of September 7, 1956, previously noted. Although registrant informed the court in the injunction proceedings that he had deposited \$40,300 to cure the deficiency, our staff did not agree that this deposit brought registrant into compliance with the rule. It questioned in particular whether a substantial part of the \$40,300 was obtained through a loan and thereby increased registrant's aggregate indebtedness. Registrant and his then counsel had on several occasions represented that registrant would explain the questioned transactions and furnish copies of the underlying documents, but this was never done."

Whatever might be the merit of the staff's impromptu position in September 1956, there was no merit to it at the time of the hearing in January 1957. As shown above, the staff could not and did not find anything concrete that was objectionable in petitioner's compliance. The Commission's reference to the statements that he would explain the questioned transactions is purely a makeweight. Where petitioner has shown compliance through transactions that are fair on their face, the staff has the burden of coming forward with something more tangible than surmise and suspicion before it can be said that petitioner had not indeed complied.

The Commission's opinion has not actually found that petitioner did not comply with the net capital requirement on August 29; speculation of non-compliance is introduced by casting suspicion on the compliance. The presumption of compliance follows from finding the requisite addition to capital. The evidence is that on August 29, one day after petitioner received notice of deficiency, he corrected that deficiency.

The deficiency having been corrected, the cause for the Commission's action terminates, since it seems too obvious to require comment that once a licensee has brought himself into compliance, there is no need or purpose in pursuing administrative discipline. After all, Congress undoubtedly sought to encourage compliance with administrative regulations, not to facilitate revocation of licenses.

Perhaps the case that best points up the deficiencies of the Commission's procedure throughout is a case involving the Commission itself, *Hughes v. Securities and Exchange Commission*, 85 App. D. C. 56, 174 F. 2d 969 (1949). There the registrant, Mrs. Hughes, was guilty of continuing breaches of fiduciary duty involving self-dealing and failure to disclose information to her customers. These violations are far more important and have a much closer relation to the public interest than petitioner's alleged technical violation of Rule X-15C3-1. The Commission's staff sent Mrs. Hughes as many as three *written* communications to secure her compliance

(this is made clear by the record on appeal, J. App. 112, 248-50, 250-4). Mrs. Hughes, however, refused to change her method of doing business, unlike petitioner here, who at all times sought to comply with the varying requirements of the staff in their interpretations of the lengthy and complex provisions of Rule X-15C3-1. Only after Mrs. Hughes' unequivocal refusal did the staff institute proceedings. The Commission, after finding that she had violated the Securities Acts, stayed revocation of her registration for thirty days to give her a chance to correct her violations. On the twenty-ninth day she submitted unsatisfactory proposals which the Commission rejected, but it further stayed her revocation pending rehearing (which was eventually denied) and pending judicial review. This Court upheld the Commission.

Since the Administrative Procedure Act had not yet gone into effect when the proceeding against Mrs. Hughes was begun (See Brief of the United States to the Court of Appeals in *Hughes v. Securities and Exchange Commission*, p. 66, n. 57), it may be that this Court was not even required to apply that Act; but the requirements of written notice and opportunity to correct were met—not once, but twice, since the Commission's decision itself gave Mrs. Hughes time to achieve compliance. Finally, the wilfulness of her conduct was proved beyond question, and was not derived from suspicion and equivocal inferences.

In petitioner's case the Commission has fallen short, not only of the *Hughes* case, but also of the bare requirements of Section 9(b) of the Administrative Procedure Act.

POINT II

SECTION 15(b) OF THE SECURITIES EXCHANGE ACT DOES NOT JUSTIFY THE REVOCATION OF PETITIONER'S REGISTRATION.

The reed on which the Commission's decision against petitioner rests appears in the following sentence of its opinion:

" * * * the existence of the injunction against registrant itself clearly furnishes a statutory basis for revocation of registrant's registration under Section 15(b) of the Exchange Act, provided we find such action to be in the public interest."

However, the injunction in the Southern District of New York which the Commission refers to cannot—as matter of law—ground a revocation for the following reasons:

1.—An injunction which invokes the sanction of revocation under Section 15(b) of the Securities Exchange Act must be an adjudication on the merits, whether preliminarily or permanently, that there is an existing violation; whereas here no finding of an existing violation was made, and the injunction merely purported to restrain petitioner in the future whenever his capital did not meet the Commission's minimum requirements.

2.—An injunction which is not bottomed on or accompanied by written notice of deficiency and an opportunity for compliance cannot be used, because of Section 9(b) of the Administrative Procedure Act, for purposes of revocation.

Not only an injunction is necessary to ground a revocation under Section 15(b) of the Securiteis Exchange Act, but also a finding that revocation is in the public interest. The Commission has clearly erred in holding that there was here a pressing public interest to revoke registration of petitioner, who had already signified his intention of ending his business as a broker-dealer by filing a notice of withdrawal dated October 19, 1956.

- a) The injunction relied on by the Commission did not adjudicate the facts essential for a revocation.

Because of the effect attributed to the injunction relied on by the Commission, it is necessary to analyze the proceedings in the Southern District of New York and the decision therein.*

**How the injunction was obtained—
pleading and proofs.**

On August 28, 1956, petitioner was served with a summons and complaint and an order to show cause and a temporary restraining order in an action which the Commission instituted against him in the United States Court for the Southern District of New York (Tr. 108; Ex. 7).

The action was begun under Section 21(e) of the Securities Exchange Act, 15 U. S. C. 78u(e), which authorizes the Commission to bring an action in the District Court to enjoin acts or practices "which constitute or will constitute a violation of the provisions" of the Securities Exchange Act, whenever it appears to the Commission that any person "is engaged or about to engage in" them. The Commission is also authorized to obtain "upon a proper showing a permanent or temporary injunction or restraining order * * *."

The complaint alleged (Par. 1) :

"It appears to the Securities and Exchange Commission, plaintiff herein, that the defendant is engaged and is about to engage in acts and practices which constitute and will constitute violations"

of the net capital requirements of the Commission.

* *Securities and Exchange Commission v. Shuck*, Civ. No. 112-267. The summons, complaint, affidavits and decision of Judge McGohey were admitted in evidence in the hearing below as Exs. 6 and 7.

The complaint further alleged (Par. 5) that "from approximately August 22, 1956 to date hereof," the petitioner, by use of the means of interstate commerce, "has been and is now effecting transactions in * * * securities * * * otherwise than on a national securities exchange," and "has permitted and is now permitting his aggregate indebtedness to all other persons to exceed two thousand (2,000) per centum of its net capital in contravention of Rule X-15C3-1." It was finally alleged (Par. 6) that petitioner would, unless enjoined, continue to engage in these acts and practices.

The complaint was accompanied by a motion for a temporary restraining order and preliminary injunction.

This motion was based upon the affidavit of Barton, the securities investigator. It recited that he had visited petitioner's office on August 22, that he had examined petitioner's books and records, and that this examination had revealed a net capital deficiency on that day. The affidavit concluded:

"In view of the defendant's failure to maintain sufficient capital in compliance with Rule X-15C3-1, it appears that unless the sanction of this Court is invoked, the defendant will continue his violations, thereby depriving other brokers, dealers, banks and customers doing business with him of the safeguards with respect to his financial responsibility which the Securities and Exchange Commission deems necessary and appropriate in the public interest and for the protection of investors."

This statement is, of course, a conclusory *non sequitur*, since the staff was in no position to assert that petitioner would continue his alleged violations unless the sanction of the Court were invoked, because the staff had never attempted to require petitioner's compliance by means of a written notice of deficiency or affording him time to comply.

Be that as it may, an *ex parte* temporary restraining order was signed which contained a similar recital and which ordered (1) that petitioner show cause on September 4, 1956, why a temporary injunction should not be granted; and (2) that, pending determination of the motion for preliminary

injunction, the petitioner be enjoined from making use of the means of interstate commerce to effect transactions in the purchase or sale of securities otherwise than on a national securities exchange at a time when his aggregate indebtedness to all other persons exceeded 2000% of his net capital.

On the hearing of the motion for a preliminary injunction, petitioner submitted an affidavit, sworn to September 1, 1956, which stated:

"MR. BARTON has reflected in his affidavit certain figures and computations which indicate the temporary and not wilfull infraction as of August 22d, 1956 but these figures are not altogether correct.

* * * Had MR. BARTON or the plaintiff revealed his findings, steps would have been taken at once to meet the minimum requirements.

* * * On the morning of August 29th, 1956 I deposited from other sources of my own a cash sum of \$40,000 which was added to the capital account of this branch of my activities.

* * * * *

The primary cause of the momentary deficiency of capital was the gradual lowering of the market price of securities in the long account. As soon as notice of capital deficiency was brought to me I corrected the situation and had it been brought to me earlier I would have made the same correction if the condition existed. There is nothing wilfull or intentionally persistent in my conduct."

The Commission submitted an unsworn document to the Court labeled "Memorandum," which made statements that were not supported by any proof before the Court, e.g.,

"The defendant is engaging in the purchase and sale of securities while in direct violation of the minimum requirements of financial responsibility prescribed by the Commission for the protection of investors against financially unsafe brokers and dealers."

It will be remembered that the affidavit of Mr. Barton, which is the only sworn proof in the case, alleges a capital deficiency

but—significantly here—does not show that petitioner transacted any business during any of the material times.

This memorandum also made legal arguments, accompanied with the citation of cases, e.g.,

“4. Along with its power to hear the case, the Court’s power to grant injunctive relief survives discontinuance of the illegal conduct. *UNITED STATES v. W. T. GRANT CO.*, 73 S. Ct. 894 (1953).

5. The purpose of an injunction is to prevent future violations. *UNITED STATES v. W. T. GRANT*, *supra*.”

The Court was thus, on the basis of decided cases, invited to issue an injunction even if there was an entire absence of any current violation of the Commission’s rule.

The Commission also submitted another unsworn document labeled “Reply Memorandum,” which made statements more appropriate for submission by affidavit, e.g., that

“during the period August 22, 1956 through August 31, 1956, when the temporary restraining order was in existence and a serious question still remained as to whether or not the monies supplied brought the defendant into compliance with Rule X-15C3-1, said defendant engaged in securities transactions, effecting purchases and sales of securities for its customers, and in effecting such transactions used * * * the means * * * of interstate commerce.”

There is not a word of proof in the record before Judge McGohey to support this allegation in what presumably was a lawyer’s memorandum.

What was decided in the injunction proceeding.

On September 6, 1956, Judge McGohey granted the Commission’s motion in a memorandum opinion which contained the following language:

“The defendant does not deny the facts charged by the Commission which constitute the violation sought

to be restrained. The defendant merely contends he was too speedily haled to court and urges that he will in the future comply with the Commission's rules. The contention is not supported by the admitted facts and I am not persuaded that the promise of future compliance is buttressed by his past record. It appears from the Commission's affidavits [sic] that the conditions complained of were first pointed out to the defendant almost a year ago."

From the use of the word "affidavits" it appears that Judge McGohey was led into error by the affidavit-like memoranda of the Commission, which were even typed on long paper and signed by the attorneys, unlike memoranda of law in the Southern District of New York. In truth, the Commission had submitted only one affidavit, that of Barton the investigator. This pointed out a capital deficiency on August 22, 1956, which was conceded in petitioner's affidavit. This is the only basis in the record for Judge McGohey's reference to "the facts charged by the Commission which constitute the violation sought to be restrained." Inasmuch as the Commission had not proved in the record that petitioner had engaged in any transactions during the period in question, and inasmuch as this was not conceded, it cannot be said and the record does not support the notion that Judge McGohey had concluded that petitioner had engaged in business during that time.

Section 21(e) of the Securities Exchange Act authorizes an injunction when it merely appears that a person is "about to engage in any acts or practices which * * * will constitute a violation * * * of any rule or regulation * * *." It is thus proper only to infer that the Judge exercised his discretion to prevent future violation without finding anything other than a simple past violation of Rule X-15C3-1. This rule speaks, not in terms of doing business with impaired capital, but in terms of permitting aggregate indebtedness to exceed 2000% of net capital. In other words, a broker may be said to violate Rule X-15C3-1 when his capital is below the mini-

mum even though he transacts no business during that time. On the other hand, he does not violate Section 15(c)(3) of the Securities Exchange Act unless he actually does transact business while his capital is impaired.

The Court's order of September 7, 1956, simply enjoined petitioner from doing business whenever his capital was impaired.

In the proceeding in the Southern District of New York, all that had to be decided in order to support the issuance of an injunction was that at one time petitioner's capital had been below the minimum and that thereby petitioner had been in violation of a rule of the Commission. There is nothing in the record or in the opinion and order of Judge McGohey to indicate that any broader finding of fact underlay his disposition of the case. The Commission has thus erred as a matter of law in making the following statement in its opinion:

" * * * the District Court's memorandum opinion and order, copies of which are a part of the record herein, clearly indicate the Court's opinion that registrant had violated Section 15(c)(3) of the Act in the past and would do so again in the future unless enjoined."

By implying that the Court had found a violation of Section 15(c)(3) of the Securities Exchange Act, which the Court did not say it had found and need not have found, the Commission in effect disregards the statement made earlier in its own opinion that "it is not necessary in this case for us to reach [the] question * * * [whether] registrant had wilfully violated Section 15(c)(3) of the Exchange Act and Rule X-15C3-1 thereunder." The Commission clearly erred in undoubtedly believing, although it has carefully refrained from saying so, that the Judge had made a finding which was not made, viz., that petitioner wilfully violated the Act and the regulations.

Section 15(b) of the Securities Exchange Act does not apply to a temporary injunction that is not dispositive on the merits.

The language of Section 15(b) of the Securities Exchange Act authorizing revocation of a broker-dealer's registration is, taken literally, extremely broad. Nonetheless, it is doubtful whether this language can be construed to sweep within its coverage a temporary injunction of a purely protective kind such as that which the District Court issued.

The very fact that sub-part (C) of the section includes "permanently" as well as "temporarily enjoined" as grounds for revocation shows that Congress was thinking primarily of injunctions issued after full hearings and based on a decision on the merits and on an existing violation.

Congress also had the more serious breaches of law and proper conduct in mind as grounds for revocation. This is brought out by the other sub-parts in the same section. Thus, sub-part (A) makes a ground for revocation the wilful making of statements false and misleading at the time and under the circumstances that they were made; sub-part (B) makes conviction of any felony or misdemeanor involving the purchase or sale of any securities or arising out of the conduct of the business of a broker or dealer a ground for revocation; and sub-part (D) makes wilful violation of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, or of any rule or regulation thereunder, ground for revocation.

These grounds are all serious and by their very nature, if not by their specific wording, require wilfulness as a necessary ingredient.

Since the revocation of a registration is a serious regulatory step, the statute authorizing revocation should not be construed so broadly as to include situations which Congress did not intend to include. *Church of the Holy Trinity v. United States*, 143 U. S. 457 (1892).

As shown above, the injunction issued in the Southern District of New York related to future matters and, by the terms

of Section 21(e) of the Securities Exchange Act, 15 U. S. C. 78u(e), and by the nature of the proof submitted to Judge McGohey, was not based upon any finding that petitioner had transacted business while his capital structure was impaired. Yet it is on such an injunction that the Commission relies for revocation of petitioner's registration.

If the Commission's position were sound, the obtaining of revocations for other than statutory cause would be easy. All the Commission's staff would have to do would be to obtain, on short notice and without a hearing on the merits, a temporary injunction—based on a corrected capital deficiency—requiring a registrant thereafter to remain in compliance with the law. Since such an injunction merely commands what the law already requires, there would be little objection to issuing it even in the absence of a hearing on the merits.*

b) The injunction relied on by the Commission was used in violation of Section 9(b) of the Administrative Procedure Act.

In the proceedings in the Southern District of New York, no mention was made of Section 9(b) of the Administrative Procedure Act. The Commission, in the exercise of its duty to protect the investing public, may undoubtedly obtain injunctions without notifying a defendant of the reason it is seeking an injunction. *Cf. Securities and Exchange Commission v. Reiter*, 146 F. Supp. 552, 555 (S. D. N. Y. 1956).

But the proceeding before the Securities and Exchange Commission, which is on review here, is an administrative proceeding, and the provisions of Section 9(b) of the Administrative Procedure Act do apply, unless the exceptions there-to are shown to be applicable.

* Some courts, however, adopt a more stringent approach in issuing temporary injunctions where the Commission has failed to demonstrate that defendants were about to make stock sales. *Securities and Exchange Commission v. Franklin Atlas Corporation*, 154 F. Supp. 395 (S.D.N.Y. 1957).

In the absence of a showing of wilfulness or of a pressing public interest, the Commission could not have revoked petitioner's registration on proof that he had violated its capital requirement on August 22, 1956, if it had not shown that it had first given him written notice of the deficiency and an opportunity to correct it. This much is undeniable. The Commission should be in no better a position because it has taken the additional step of obtaining an injunction, but without giving written notice and opportunity to correct.

The Commission's assertion that the existence of an injunction under the Securities Exchange Act of 1934 (if coupled with a finding of public interest) is sufficient to ground a revocation ignores and nullifies Section 9(b) of the Administrative Procedure Act. What the Commission is in effect alleging is that the 1934 act repealed by implication Section 9(b) of the 1946 act.

Not only is this contention on its face erroneous, but the Supreme Court has also made it clear that Section 9(b) of the Administrative Procedure Act confers additional substantive rights which inhere in and modify the provisions of the regulatory acts which it affects.

Pan-Atlantic Steamship Corp. v. Atlantic Coast Line R.R., 353 U. S. 436 (1957), was decided under the last sentence of Section 9(b) of the Administrative Procedure Act. This provides that, where a licensee has made appropriate application for a renewal or a new license, no license with reference to any activity of a continuing nature shall expire until the application has been finally determined by the agency. This was held to prevail over Section 311(a) of the Interstate Commerce Act, 49 U. S. C. 911(a), which gives the Commission power to grant certain "temporary authority" to a common carrier by water, "but not for more than an aggregate of one hundred and eighty days." Pan-Atlantic had applied to the Interstate Commerce Commission for a permanent certificate of public convenience and necessity. The Commission had granted it a temporary authority to operate for

one hundred and eighty days, but it did not conclude the proceedings on the application before the expiration of the one hundred and eighty day period. It therefore authorized Pan-Atlantic to continue to act under the temporary authority until the application for a permanent certificate had been finally determined. The Supreme Court held that the Commission had authority, under Section 9(b) of the Administrative Procedure Act, to grant an extension that conflicted with the literal language of Section 311(a) of the Interstate Commerce Act. Mr. Justice Douglas, writing for the Court, said, 353 U. S. at 439:

"Section 9(b) of the Administrative Procedure Act contains a new rule that supplements the prior authority granted by § 311(a) of the Interstate Commerce Act. Initially, the Commission can do no more than issue a temporary authority good for 180 days. But once the conditions of § 9(b) are satisfied, an extension in the interests of economy and efficiency is authorized."

Mr. Justice Douglas concluded, 353 U. S. at 440:

"Where the remedy for an evil is clear, the remediable provisions of the Administrative Procedure Act should be given full effect. * * * We conclude that an harmonious reading of § 311(a) and § 9(b) requires the latter to be read as supplementing the former * * *."

The *Pan-Atlantic* case points the way to a decision here. Insofar as administrative proceedings are concerned, Section 15(b) of the Securities Exchange Act must be interpreted consistently with Section 9(b) of the Administrative Procedure Act. The issuance of a temporary injunction can no longer be an automatic ground for license revocation without proof of compliance with the provisions of Section 9(b) of the Administrative Procedure Act requiring written notice and opportunity to correct.

This harmonization of the two acts is essential to preserve the scope and to fulfill the purpose of the Administrative

Procedure Act, while at the same time it does no harm to the regulatory scheme of the Securities Exchange Act, since the power of the Commission to obtain injunctions whenever, in its sole discretion, it considers such action necessary, is not impaired. The only limitation is that such an injunction shall not become ground for revocation of a license unless the Commission has first given notice and an opportunity to correct, or unless it can show wilfulness or the exigency of the public interest.

The Commission has apparently taken the position (Opinion n. 5) that the existence of an injunction in effect takes the case out of the coverage of Section 9(b) of the Administrative Procedure Act, since, the Commission says, "it is difficult to see what further advance opportunity to achieve compliance would be appropriate." This misses the point altogether. Notice and opportunity to correct are required, whether or not an injunction is in existence—if the Commission seeks to revoke petitioner's registration. Besides, petitioner did achieve compliance once he received written notice of capital deficiency.

Similarly, the remarks in the same footnote to the effect that petitioner had taken no steps to vacate the temporary injunction in the Southern District of New York is beside the point. The propriety or impropriety of the temporary injunction was not at issue before the Securities and Exchange Commission, and it is not in issue before this Court on review of the Commission's decision revoking petitioner's registration. What petitioner asserts is that the temporary injunction, whether vacated or not vacated, cannot be used in a revocation proceeding unless due account is taken of Section 9(b) of the Administrative Procedure Act.

The Commission has bypassed the Administrative Procedure Act. Since, as we have shown, it may not rely solely upon the temporary injunction, it has no ground for revoking petitioner's registration under a harmonious reading of the Securities Exchange Act and the Administrative Procedure Act.

- c) The Commission has not shown that it is in the public interest to revoke petitioner's registration.**

Before even an injunction of the kind contemplated by Section 15(b) of the Securities Exchange Act and properly obtained under Section 9(b) of the Administrative Procedure Act may be used to ground a revocation, Section 15(b) of the Securities Exchange Act requires a finding that it be in the public interest that the revocation be made. The Commission has made such a finding, and has committed clear error in so doing.

In stating that it was in the public interest to revoke petitioner's registration, the Commission has examined and analyzed the course of discussions and negotiations between petitioner and the Commission's staff from November 1955 on. There is no legal support for a finding of a public interest in the revocation of petitioner's registration. As demonstrated in Point I above, it is improper for the Commission to rely upon this history, in the absence of any written notice by the Commission to petitioner that he was violating any of its regulations. The Commission's staff believed that due enforcement was satisfied by continued discussions with petitioner—not charges of violations—and there is no ground for the Commission's now asserting that, in retrospect, these discussions take on the somber hue of "a lack of any real concern" on petitioner's part over the Commission's capital requirements.

The public interest which is here being considered is the general public interest under Section 15(b) of the Securities Exchange Act. This includes the facts that petitioner had, by October 19, 1956, decided to withdraw as a broker-dealer (Tr. 42), and that he had paid all his creditors and that he has no liabilities to his customers (Tr. 216). Since the purpose of Rule X-15C3-1 is to insure that broker-dealers have sufficient capital stability in order to be answerable for the funds which they receive from their customers, it is obvious that the requirements of the public interest were fully satisfied before the matter came to hearing and the decision made by the Commission.

CONCLUSION

The order of the Commission revoking petitioner's registration should be vacated and the Commission's revocation proceedings should be dismissed.

Respectfully submitted,

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APPENDIX

Statutes and Regulations Involved

Administrative Procedure Act § 7(c), 5 U. S. C. § 1006(c), 60 Stat. 241.

"In hearings which section 4 or 5 of this act requires to be conducted pursuant to this section——

* * *

(c) except as statutes otherwise provide, the proponent of a rule or order shall have the burden of proof."

Administrative Procedure Act § 9(b), 5 U. S. C. § 1008(b), 60 Stat. 242.

"(b) * * * Except in cases of willfulness or those in which public health, interest, or safety requires otherwise, no withdrawal, suspension, revocation, or annulment of any license shall be lawful unless, prior to the institution of agency proceedings therefor, facts or conduct which may warrant such action shall have been called to the attention of the licensee by the agency in writing and the licensee shall have been accorded opportunity to demonstrate or achieve compliance with all lawful requirements. In any case in which the licensee has, in accordance with agency rules, made timely and sufficient application for a renewal or a new license, no license with reference to any activity of a continuing nature shall expire until such application shall have been finally determined by the agency."

Securities Exchange Act § 15(b), 15 U. S. C. § 78o(b), 48 Stat. 895.

"The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to

or revoke the registration of any broker or dealer if it finds that such denial or revocation is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has wilfully made or caused to be made in any application for registration pursuant to this subsection or in any document supplemental thereto or in any proceeding before the Commission with respect to registration pursuant to this subsection any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact; or (B) has been convicted within ten years preceding the filing of any such application or at any time thereafter of any felony or misdemeanor involving the purchase or sale of any security or arising out of the conduct of the business of a broker or dealer; or (C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security; or (D) has willfully violated any provision of the Securities Act of 1933, or of this chapter, or of any rule or regulation thereunder. * * * Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors. Any registered broker or dealer may, upon such terms and conditions as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission.

Securities Exchange Act § 15(c)(3), 15 U. S. C. § 78o(c)(3), 48 Stat. 895.

“(3) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers’ acceptances, or commercial bills) otherwise than on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility of brokers and dealers.”

Securities Exchange Act § 21(e), 15 U. S. C. § 78u(e), 48 Stat. 899.

“(e) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States * * * to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond.”

Securities Exchange Act Rule X-15B-6, 17 Code Fed. Reg. § 240.15b-6.

“If a notice to withdraw from registration is filed by a broker or dealer pursuant to Section 15(b), it shall become effective on the thirtieth day after the filing thereof with the Commission, unless prior to its effective date the Commission institutes a proceeding pursuant to Section 15(b) to revoke or suspend the registration of such broker or dealer or to impose terms and conditions upon such withdrawal. If the Commission institutes such a proceeding, or if a notice to withdraw from registration is filed with the Commission at any time subsequent to the date of the issuance of

a Commission order instituting proceedings pursuant to Section 15 (b) to revoke or suspend the registration of the broker or dealer filing such notice, and during the pendency of such a proceeding, the notice to withdraw shall not become effective except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors."

Securities Exchange Act Rule X-15C3-1, 17 Code Fed. Reg.
§ 240.15c3-1.

(a) *General provision.*—No broker or dealer shall permit his aggregate indebtedness to all other persons to exceed 2,000 per centum of his net capital.

* * * * *

(c) *Definitions.*—For the purpose of this rule:

(1) The term "aggregate indebtedness" shall be deemed to mean the total money liabilities of a broker or dealer arising in connection with any transaction whatsoever, including, among other things: money borrowed; money payable against securities loaned and securities "failed to receive"; the market value of securities borrowed (except for delivery against customers' sales) to the extent to which no equivalent value is paid or credited; customers' free credit balances; credit balances in customers' accounts having short positions in securities; and equities in customers' commodities futures accounts; but excluding.

(A) indebtedness adequately collateralized, as hereinafter defined, by securities or spot commodities owned by the broker or dealer;

(B) indebtedness to other brokers or dealers adequately collateralized as hereinafter defined, by securities or spot commodities owned by the broker or dealer;

(C) amounts payable against securities loaned which securities are owned by the broker or dealer;

(D) amounts payable against securities failed to receive which securities were purchased for the account of, and have not been sold by the broker or dealer;

(E) indebtedness adequately collateralized, as hereinafter defined, by exempted securities;

(F) amounts segregated in accordance with the Commodity Exchange Act and the rules and regulations thereunder;

(G) fixed liabilities adequately secured by real estate or any other asset which is not included in the computation of "net capital" under this rule;

(H) liabilities on open contractual commitments;

(I) indebtedness subordinated to the claims of general creditors pursuant to a satisfactory subordination agreement, as hereinafter defined;

(2) The term "net capital" shall be deemed to mean the net worth of a broker dealer (that is, the excess of total assets over total liabilities), adjusted by

(A) adding unrealized profits (or deducting unrealized losses) in the accounts of the broker or dealer and, if such broker or dealer is a partnership, adding equities (or deducting deficits) in accounts of partners, as hereinafter defined;

(B) deducting fixed assets and assets which cannot be readily converted into cash (less indebtedness secured thereby) including, among other things, real estate; furniture and fixtures; exchange memberships; prepaid rent, insurance and expenses; good will; organization expenses; all unsecured advances and loans; customers' unsecured notes and accounts; and deficits in customers' accounts, except in bona fide cash accounts within the meaning of Section 4(c) of Regulation T of the Board of Governors of the Federal Reserve System;

(C) deducting the percentages specified below of the market value of all securities, long and short (except exempted securities) in the capital, proprietary and other accounts of the broker or dealer, including securities loaned to the broker or dealer pursuant to a satisfactory subordination agreement, as hereinafter defined, and if such broker or dealer is a partnership, in the accounts of partners, as hereinafter defined.

(i) in the case of non-convertible debt securities having a fixed interest rate and a fixed maturity date are not in default, if the market value is not more than 5% below the face value, the deduction

shall be 5% of such market value; if the market value is more than 5% but not more than 30% below the face value, the deduction shall be a percentage of market value, equal to the percentage by which the market value is below the face value; and if the market value is 30% or more below the face value, such deduction shall be 30%;

(ii) in case of cumulative, non-convertible preferred stock ranking prior to all other classes of stock of the same issuer, which is not in arrears as to dividends, the deduction shall be 20%;

(iii) on all other securities, the deduction shall be 30%;

provided, however, that such deduction need not be made in the case of (i) a security which is convertible into or exchangeable for other securities within a period of 30 days, subject to no conditions other than the payment of money, and the other securities into which such security is convertible, or for which it is exchangeable, are short in the accounts of such broker or dealer or partner, or (ii) a security which has been called for redemption and which is redeemable within 90 days.

(D) deducting 30% of the market value of all "long" and all "short" future commodity contracts (other than those contracts representing spreads or straddles in the same commodity and those contracts offsetting or hedging any "spot" commodity positions) carried in the capital, proprietary or other accounts of the broker or dealer and, if such broker or dealer is a partnership, in the accounts of partners as hereinafter defined;

(E) deducting, in the case of a broker or dealer who has open contractual commitments, the respective percentages specified in subparagraph (C) above of the value (which shall be the market value whenever there is a market) of each net long and each net short position contemplated by any existing contractual commitment in the capital, proprietary and other accounts of the broker or dealer and, if such broker or dealer is a partnership, in accounts of partners, as hereinafter defined; *provided, however*, that this deduction shall not apply to exempted securities, and that the deduction with respect to any individual commitment shall

be reduced by the unrealized profit, in an amount not greater than the percentage deduction provided for in subparagraph (C), (or increased by the unrealized loss) in such commitment; and that in no event shall an unrealized profit on any closed transactions operate to increase net capital;

(F) excluding liabilities of the broker or dealer which are subordinated to the claims of general creditors pursuant to a satisfactory subordination agreement as herein defined; and

(G) deducting, in the case of a broker or dealer who is a sole proprietor, the excess of (i) liabilities which have not been incurred in the course of business as a broker or dealer over (ii) assets not used in the business.

(3) The term "exempted securities" shall mean those securities specifically defined as exempted securities in Section 3(a) of the Securities Exchange Act of 1934;

(4) the term "accounts of partners", where the broker or dealer is a partnership, shall mean accounts of partners who have agreed in writing that the equity in such accounts maintained with such partnership shall be included as partnership property;

(5) the term "contractual commitments" shall include underwriting, when-issued, when-distributed and delayed delivery contracts, endorsements of puts and calls, commitments in foreign currencies, and spot (cash) commodities contracts, but shall not include uncleared regular way purchases and sales of securities and contracts in commodities futures; a series of contracts of purchase or sale of the same security conditioned, if at all, only upon issuance may be treated as an individual commitment;

(6) indebtedness shall be deemed to be "adequately collateralized" within the meaning of this rule, when the difference between the amount of the indebtedness and the market value of the collateral is sufficient to make the loan acceptable as a fully secured loan to banks regularly making comparable loans to brokers or dealers in the community;

(7) the term "satisfactory subordination agreement" shall mean a written agreement between the broker or dealer and a lender, which agreement is binding and enforceable in accordance with its terms upon the lender, his creditors, heirs, executors, administrators, and assigns, and which agreement satisfies all of the following conditions:

(A) it effectively subordinates any right of the lender to demand or receive payment or return of the cash or securities loaned to the claims of all present and future general creditors of the broker or dealer;

(B) it is not subject to cancellation at the will of either party and is for a term of not less than one year;

(C) it provides that it shall not be terminated, rescinded or modified by mutual consent or otherwise, if the effect thereof would be to make the agreement inconsistent with the conditions of this rule, or to reduce the net capital of the broker or dealer below the amount required by this rule;

(D) it provides that no default in the payment of interest or in the performance of any other covenant or condition by the broker or dealer shall have the effect of accelerating the maturity of the indebtedness;

(E) it provides that any notes or other written instruments evidencing the indebtedness shall bear on their face an appropriate legend stating that such notes or instruments are issued subject to the provisions of a subordination agreement which shall be adequately referred to and incorporated by reference;

(F) it provides that any securities or other property loaned to the broker or dealer pursuant to its provisions may be used and dealt with by the broker or dealer as part of his capital and shall be subject to the risks of the business.

(8) the term "customer" shall mean every person except the broker or dealer; *provided, however*, that partners who maintain "accounts of partners" as herein defined shall not be deemed to be customers insofar as such accounts are concerned.

REPLY BRIEF FOR PETITIONER

UNITED STATES COURT OF APPEALS

DISTRICT OF COLUMBIA CIRCUIT.

MILTON J. SHUCK, doing business as
M. J. SHUCK COMPANY,
Petitioner,

—v.—

SECURITIES AND EXCHANGE
COMMISSION,
Respondent.

No. 14208

PETITION TO REVIEW ORDER OF SECURITIES AND EXCHANGE COMMISSION

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UNITED STATES COURT OF APPEALS

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SECURITIES AND EXCHANGE
COMMISSION,
Respondent.

No. 14208

REPLY BRIEF FOR PETITIONER

The Net Capital Requirements

The brief of the Securities and Exchange Commission properly stresses the importance of the Commission's net capital rule as a means of insuring a broker-dealer's financial responsibility. But the brief has not pointed out the following significant matters:

1. The net capital rule by its very nature cannot be simple and clearcut. Its pertinent text in the appendix to petitioner's main brief covers almost five pages. The definition of "satisfactory subordination agreement" therein alone covers almost a page. The rule is cast in technical terms and refers to technical marketing concepts. The rule requires interpretation, and there can be disagreements in good faith over its meaning.

2. The financial requirements of the rule do not result in a fixed and stable capital position, inasmuch as the position can and does vary with the day to day and hour by hour

fluctuations of the market. It is thus possible for a registrant to find himself out of compliance with the rule through no fault of his own solely through market fluctuations. Deficiencies are thus entirely possible without any wilfulness at all on the part of the registrant.

3. It has been the practice of the Commission to negotiate with registrants to resolve differences in the interpretation of the rule and to assure compliance. The present case is but one instance of such negotiation, and, as the record shows, it was conducted without haste or pressure for a period of months and with delays and postponements caused by changes of attorneys handling the matter and courtesies between counsel (R. 172-176). It does not now behoove the Commission to pass over this habitual behavior as being only "extreme leniency and indulgence" on its part and at the same time to condemn petitioner for alleged wilfulness because he too continued to negotiate—with the Commission (SEC Brief, p. 5). If the Commission is to be permitted to do what it has done in this case, i.e., negotiate with a registrant over a period of time and then suddenly invoke the sanction of an injunction without the written warning required by the Administrative Procedure Act and without a showing that the registrant's obvious wilfulness or the pressing public interest requires omission of the written notice, registrants will be less ready to negotiate openly and freely with the Commission, and, as a matter of business expediency, to make concessions to the Commission's demands whenever they go beyond the minimum legal standards, and thus the Commission will come to find itself deprived of the flexible enforcement device of negotiation.

Facts

The Commission stresses that its inspectors orally called petitioner's alleged violations of the net capital requirement to his attention. This is irrelevant, since the Commission does not deny that no written notice, as required by the Ad-

ministrative Procedure Act, was ever given to him. There is no rule that any number of oral notices (given, indeed, by persons on the Commission's staff with almost no powers to speak for or bind it) can ever replace the written notice required by statute.

The Commission is inaccurate in its allegation that "Petitioner did not avail himself of * * * opportunities to achieve compliance" (SEC Brief, p. 3) with the net capital requirement. The record is clear that petitioner at all times in good faith sought to work out with the Commission's staff agreements that would be satisfactory to it. The record is also clear that there is nothing to impugn the satisfactoriness of petitioner's compliance except unsupported statements made at the hearing, statements based on mere surmise and suspicion, but relied on in the Commission's brief as if they had been proved.*

The fact remains, however, that the Commission afforded petitioner *no* opportunity to achieve compliance, since by the very language of the Administrative Procedure Act opportunity must follow a written notice of deficiency, and no written notice was ever given.

The Commission's brief finds impropriety and illegality not only in petitioner's acts but also in what he did not do. Thus: "At no time in these eight months had petitioner ever denied that he was in violation of the rule" (SEC Brief, p. 5). It is equally true that at no time had he ever admitted that he was in violation of the rule. What he did was to seek to bring himself into compliance with the interpretations of the Commission's rules made by particular and different members of the staff, fluctuating though these might be. This proves nothing derogatory about petitioner, and it certainly does not discharge the burden of proof which the Administrative Procedure Act has placed upon the Commission.

* See, e.g., SEC Brief, p. 6: "If, of course, as the staff suspected, this \$40,000 was borrowed, then instead of correcting the deficiency, it only increased the indebtedness."

The Commission's brief does not mention the provision in the Administrative Procedure Act which places the burden of proof on the Commission. § 7(c), 5 U. S. C. 1006(c). After reading its brief one would think that the burden of proof were upon petitioner to justify all his actions, while the Commission's conjectures, surmises, and misapplications of the law were vested with an almost irrebuttable presumption of validity.

POINT I

THERE IS NO ATTACK UPON THE INJUNCTION ISSUED IN THE SOUTHERN DISTRICT OF NEW YORK. THE ADMINISTRATIVE PROCEDURE ACT ITSELF IMPOSES CONDITIONS UPON THE EFFECTIVENESS OF SUCH AN INJUNCTION IN SUBSEQUENT REVOCATION PROCEEDINGS.

The Commission makes the wholly unwarranted assertion that petitioner is collaterally attacking before this Court the injunction issued in the United States Court for the Southern District of New York in *Securities and Exchange Commission v. Shuck*, Civ. No. 112-267.

Although the point was made clearly enough in petitioner's main brief, it apparently must be emphasized again:

Petitioner does not question the power or the duty of the Commission to seek injunctions under Section 15(b) of the Securities Exchange Act of 1934, 15 U. S. C. 78o(b), whenever in its unfettered discretion it believes that an injunction is needed to protect investors or to fulfill any of the other purposes of the Securities Exchange Act.

Petitioner does not question the power of the courts to issue temporary injunctions at the suit of the Commission without advance written notice to a registrant and without a full hearing on the merits.

In short, the Commission may seek and the courts may grant injunctions to the fullest extent of the powers they

have under principles of equitable jurisprudence and the statutes of the United States.

But when the Commission seeks to use an injunction, which it has obtained to protect the investing public, for disciplinary purposes, the principles of the Administrative Procedure Act require that the registrant whom the Commission seeks to discipline be given written notice of deficiency and an opportunity to correct, unless the exceptions for wilfulness and the public interest, as set forth in § 9(b) of that act, 5 U. S. C. 1008(b), are applicable.

The Commission's brief has ignored *Pan-Atlantic Steamship Corp. v. Atlantic Coast Line R.R.*, 353 U. S. 436 (1957), referred to in petitioner's main brief (pp. 33-4), which makes it clear that § 9(b) of the Administrative Procedure Act confers additional substantive rights which inhere in and modify the provisions of the regulatory acts which it affects.

Petitioner's main brief analyzed the provisions of § 15(b) of the Securities Exchange Act and the proceedings, decision, and injunction in *Securities and Exchange Commission v. Shuck*, S.D.N.Y., Civ. No. 112-267. This analysis showed that, under the Securities Exchange Act, it was possible for the United States Court for the Southern District of New York to have enjoined petitioner from transacting business in interstate commerce at any future time when his capital might be impaired without there ever having been proof that he had ever transacted business while his capital was impaired. In other words, it was entirely possible for petitioner to have been enjoined in the absence of a finding of an existing violation. The decision and injunction of the District Court are as consistent with this view as with the view that the Court had found a violation. It is thus improper for the Commission to assert that the District Court found an existing violation which the Court was not required to and did not find.

Petitioner argued in his main brief that an injunction issued without a finding of an existing violation was not such

an injunction as to justify revocation of petitioner's registration.

Petitioner further argued that the injunction could not be used to effect revocation of his registration unless the Administrative Procedure Act had been complied with, and petitioner showed that it had not been.

By referring to petitioner's analysis of the proceedings in the Southern District of New York as a "collateral attack" upon the injunction issued by Judge McGohey, the Commission has palpably misconstrued petitioner's argument. This misconstruction has led the Commission into the frivolous argument that acceptance of petitioner's views "would effectively deprive the Commission of the power to revoke a registration on the basis of even a permanent injunction entered by consent or by default" (SEC Br., p. 10). A finding of an existing violation can be made on consent or default as well as after a hearing on the merits; it is the finding of a present existing violation which justifies revocation, not merely the fact that the Court accorded a hearing.

Nowhere has petitioner contended that the decision of the United States Court for the Southern District of New York was erroneous. Nor is petitioner attempting to relitigate before this Court the questions presented in the Southern District of New York, unless it can be said that an analysis of a previous decision to determine its holding constitutes a relitigation. This assertion should come as a surprise to lawyers trained in case law techniques.

The case in the Southern District of New York by itself proves petitioner's contention that not every discretionary injunctive order is such an injunction within the meaning of § 15(b) of the Securities Exchange Act, 15 U. S. C. 78o(b), as justifies revocation. After the Commission had obtained its temporary injunction against petitioner in September, 1956, it took no further steps to bring the case on for hearing. Defendant there timely filed its answer, which was in effect a general denial; defendant is thus not in default (R. 271A). The Commission's staff, however, by its failure to proceed with the case, caused it to become subject to dismissal

as of December 1957 for failure to prosecute, in accordance with S.D.N.Y. General Rule 21:

"Causes which have been pending for more than one year without any proceedings having been taken may be dismissed for want of prosecution by the court on its own motion at a general call of such cases upon not less than thirty (30) days' notice given by the clerk of this court by mail addressed to the attorneys or proctors of record. Notice of the call of such causes shall be published in the New York Law Journal, or otherwise as the court directs. Such calendar shall be called on the first Fridays of June and December."*

The case in the Southern District has in effect died of inanition, and the temporary injunction does not survive it. " * * * [A] preliminary injunction is *ipso facto* dissolved by a dismissal of the complaint * * *." 7 Moore, Federal Practice ¶ 65.07 (2d ed. 1955). Yet it is on the basis of such an injunction, now as good as vacated, issued without proof of existing violation, in a case which the Commission's staff has never brought to a trial on the merits, that the Commission asserts that the revocation of petitioner's registration is predicated.

POINT II

THE COMMISSION HAS NOT SHOWN THAT IT WAS IN THE PUBLIC INTEREST TO REVOKE PETITIONER'S REGISTRATION.

There is no evidence of prejudice to the public interest which required the Commission to revoke petitioner's registration.

* The reason the case was not dismissed last December may be that, as a matter of practice, the Clerk's office in the Southern District of New York does not put the more recent of such cases on the dismissal calendar.

The Commission itself has proved that the public interest was not involved in this case by its failure at any time to give petitioner written notice of any alleged capital deficiency. This simple step would have fully protected the public interest and obviated all the problems which the Commission now faces in attempting to sustain its decision, but the Commission never took it.

It was not until after petitioner had closed his business, paid all his customers and creditors, and filed notice of withdrawal of his registration that the Commission belatedly invoked public interest to justify revoking his registration.

The Commission is in no position to assert that the public interest requires petitioner's registration to be revoked because of his alleged capital deficiencies from late 1955 to July 1956 (when the Commission admitted petitioner was in compliance), when the Commission, which was aware of these alleged deficiencies throughout this period, did nothing to vindicate the public interest at a time when, on the Commission's theory, prejudice to the investing public might have been found. If the Commission is right here, what it calls its "extreme leniency and indulgence" (SEC Brief, p. 5) should deserve a harsher characterization.

The public interest is not something that is based on or developed out of surmise and suspicion and equivocal inferences. A finding that it is in the public interest to revoke petitioner's registration cannot be made on unsupported assertions of the Commission* and arguments that overturn the burden of proof, which the Administrative Procedure Act imposes on the Commission, by placing it on petitioner.**

The Commission has in effect grudgingly admitted that the Commission's own order for proceedings did not authorize the staff to prove a case against petitioner on alleged capital

* E.g., SEC Brief, p. 12: " * * * undisputed and long uncorrected violations * * *."

** E.g., *ibid.* " * * * he [petitioner] never did establish that this particular violation was corrected * * *."

deficiencies occurring during the period before August 22, 1956 (SEC Brief, p. 12). It attempts now to justify the use of this unauthorized evidence by asserting that it is relevant to the question of the public interest as distinct from that of violation. The Commission's argument is that the temporary injunction in the Southern District of New York, now as good as dead, furnishes ground for revocation under § 15(b) of the Administrative Procedure Act if the Commission finds it in the public interest to do so, and that the Commission may utilize any sort of remote, unprovable and unproved allegations to determine what is in the public interest.

As shown in Point I above, however, the Commission's basic premise is faulty, since the injunction issued in the Southern District of New York may not be used here to ground a revocation. Therefore petitioner's alleged violations before the date specified in the order for proceedings have no relevance.

As a matter of fact, the transcript of the hearings show that the Commission's present argument is an afterthought. The allegations of the petitioner's non-compliance were introduced in an effort to bolster a sagging case after it had become apparent (R. 67-9) that the staff had instituted and conducted the proceedings in disregard of the Administrative Procedure Act.

The cases which the Commission cites are inapposite. It is one thing for an administrative agency, in framing a remedy, to take into consideration irrefutable material, such as the record of actions taken by the New York Stock Exchange and the National Association of Securities Dealers, as in *R. H. Johnson & Co. v. Securities and Exchange Commission*, 97 App. D. C. 364, 231 F. 2d 523, cert. denied 352 U. S. 844 (1956). It is another thing for it to attempt to pull itself up by its own bootstraps, convincing itself by unproved allegations and surmise and suspicion that petitioner is deserving of punishment and then using the same unfounded allegations and surmise and suspicion to determine what the punishment should be.

Similarly, once a jury in a state court has determined a defendant's guilt in a criminal case solely on the basis of proper evidence in the record, the Constitution does not forbid the judge, in determining the sentence, to consider material which was not in the record but whose accuracy defendant did not even seek to challenge. *Williams v. New York*, 337 U. S. 241, 244 (1949). On the contrary, petitioner here at all times challenged the relevance of the matters not embraced in the Commission's order for proceedings and the inferences the Commission sought to draw from them.*

The Commission's argument here is as wholly devoid of merit as it is illogical.

POINT III

THE COMMISSION HAS NOT COMPLIED WITH THE NOTICE PROVISIONS OF THE ADMINISTRATIVE PROCEDURE ACT, AND THE EXCEPTIONS ARE NOT APPLICABLE.

To begin with, the Commission is inaccurate in framing the third of the Questions Presented in its brief. The question includes this language:

“ * * * petitioner repeatedly and admittedly violated the laws relating to financial responsibility of broker-dealers * * * .”

On the basis of this allegation, the Commission asks this Court whether petitioner was entitled to receive written notice of capital deficiency and an opportunity to correct under Section 9(b) of the Administrative Procedure Act.

The Commission here assumes what it failed to prove. Nothing but the Commission's unsupported allegations are

* Since *Gonzales v. United States*, 348 U. S. 407, 412 n. 4 (1955), it is unclear whether the *Williams* case is applicable to federal administrative proceedings.

back of the charge that petitioner "repeatedly" violated the net capital requirements. The only violation that can be said to exist was that of August 22, 1956.

Neither did petitioner "admittedly" violate the net capital requirements. The record shows he admitted that there was a capital deficiency on August 22, 1956 (R. 260C-260D).

The Commission has admitted that petitioner did not receive congressionally mandated written notice (of the capital deficiency of August 22, 1956) and a reasonable opportunity to correct the alleged deficiency (R. 72, 73). The Commission seeks to excuse its failure to comply with the congressional mandate by alleging that petitioner had acted wilfully and that the public interest required that no written notice or opportunity to correct be given. There is no substantial evidence in the record to sustain the excuses proffered by the Commission.

The Commission predicates its excuses on mistaken reading of the statutory standard; it misinterprets § 9(b) of the Administrative Procedure Act. The misinterpretation may stem from the ignoring of the applicable legislative history referred to in petitioner's main brief, pp. 13-14. This legislative history shows that, for the purposes of the Administrative Procedure Act, wilfulness "must be manifest" and that the public interest exception demands the existence in the record of "a situation requiring immediate action irrespective of the equities * * *." The Commission contends, without supporting authority, that the requirements of written notice and opportunity to correct were intended to benefit only one who had "inadvertently or unintentionally violated a statute or rule * * *." (SEC Brief, p. 13.)

Certainly the cases which the Commission cites do not support its argument. In the *Hughes* case, as pointed out in petitioner's main brief, pp. 22-3, the Commission had given written notice and the registrant's activities were wilful under any definition of the term.

In the *Air Transport Associates* case, the Civil Aeronautics Board had given written notice. See 199 F. 2d at 186.

It is perhaps easiest to determine the meaning of "wilfulness" and "public interest" by considering the practical aspects. The Administrative Procedure Act was designed to insure fair treatment for registrants. At the same time it was not designed to hamstring administrative agencies in the performance of necessary functions. It would be fatuous for the Commission to assert that the necessity of giving petitioner written notice by means of a simple one page letter would have interfered with or hindered it in any way. It would also be fatuous to assert that petitioner's single capital deficiency was so fraught with peril to the investing public that it was necessary for the Commission to discipline him forthwith, especially since, if the Commission is correct, similar deficiencies had existed for a long time and the Commission never thought it worth its while so to have them corrected.

The Commission has not shown by any evidence that the August 1956 deficiency was attributable to anything other than temporary market fluctuations. This does not establish wilfulness, even under the Commission's definition (SEC Br., p. 14), since petitioner could be out of compliance as a result of market fluctuations without himself doing anything or knowing that he was breaking any law. The Commission has admitted, although backhandedly, that the respondent was in full compliance with the capital requirements rules in July, 1956, the preceding month (SEC Brief, p. 5). The negotiations prior to July 1956 with the Commission establish only the prior negotiations and not wilfulness. The immediate addition of further capital to the business, within a day or so, does not square with a charge of wilfulness. Nor, as the record shows, does the staff's concession that during the next weeks and months that the petitioner remained in compliance with the rules (R. 41, 122). This is not wilfulness as Congress intended nor a threat to the public interest requiring immediate action. Petitioner concededly has paid all his customers and creditors (R. 216); the public interest

does not require him to be expelled from the ranks of securities dealers when he has already sought to leave voluntarily.

The Commission asserts yet another excuse for failure to conform to congressional requirements, viz., that the entry of an injunction "necessarily involve[s] the element of willfulness" (SEC Brief, p. 15). As shown in Point I above, and in petitioner's main brief, the injunction entered in the Southern District of New York need not have been and was not based upon any finding of wilfulness. The Commission is here merely clutching at straws.

CONCLUSION

The order of the Commission revoking petitioner's registration should be vacated and the Commission's revocation proceedings should be dismissed.

Respectfully submitted,

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Dated : April 23, 1958.

BRIEF FOR RESPONDENT

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 14,208

MILTON J. SHUCK, Doing Business as
COMPANY, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER OF THE
SECURITIES AND EXCHANGE COMMISSION

THOMAS G. MEEKER,
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ELLWOOD L. ENGLANDER,
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United States Court of Appeals
For the
District of Columbia Circuit
FILED APR 1 1958
J. J. SHUCK
J. W. Stewart
CLERK

QUESTIONS PRESENTED

1. When the Securities and Exchange Commission, pursuant to authority granted it by statute, finds it in the public interest to revoke the registration of petitioner, a broker-dealer, and the revocation is based on an injunction entered against him by a United States District Court, which injunction is still in effect, may petitioner collaterally attack the injunction before the Commission or in this Court on review of the order of revocation?

2. Was there substantial evidence on which the Commission could find that it was in the public interest to revoke petitioner's registration?

3. When, over a period of nine months, petitioner repeatedly and admittedly violated the laws relating to financial responsibility of broker-dealers notwithstanding numerous admonitions and warnings by the Commission's staff, and when a District Court has issued an injunction restraining further violations, should this Court set aside a revocation of his registration on the ground that he had not received further written notice of his violation, pursuant to Section 9(b) of the Administrative Procedure Act, particularly when that section specifically makes such notice unnecessary in cases of willfulness and those relating to the public interest?

III

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COUNTERSTATEMENT OF THE CASE

THE NET CAPITAL REQUIREMENTS

Since this is the first time, so far as we are aware, that the net capital requirements of the Act and the regulations thereunder have been before this Court, a brief description of them might be helpful to the Court.

It goes without saying that in any type of regulation of brokers and dealers, who transact a securities business with the funds and assets of their customers, one of the most vital factors in the protection of the public is that of the broker's or dealer's financial responsibility. This term means considerably more than merely an excess of assets over liabilities. A broker whose balance sheet, for instance, consists of ownership of a piece of real estate valued at \$50,000, and moneys owing to his customers in the amount of \$49,000 may not be insolvent in the bankruptcy sense. But that is little comfort to a customer who wants his money and cannot get it. In the securities business, financial responsibility, in addition to solvency, requires the maintenance of a minimum condition of liquidity at all times in order to meet the day-to-day obligations arising in the course of securities transactions. The securities industry, the stock exchanges and the Commission are unanimous in their agreement that a mere equilibrium of assets and liabilities is not a condition compatible with the public interest and the protection of investors.

Many of the state blue sky laws, in their regulation of brokers and dealers, have imposed bonding requirements as a protection to investors, some, of course, more stringent than others. Congress, in its system of regulation, has not required a surety bond. But when the Securities Exchange Act of 1934 was adopted, and when the Congress was primarily concerned with the regulation of exchanges and of exchange members, Congress borrowed the time-tested idea from the New York Stock Exchange of limiting the aggregate indebtedness to a spe-

cified multiple of the "net capital." Thus in Section 8(b) of the Act, the Congress established the maximum ratio of twenty to one, granting authority to the Commission to fix even a smaller ratio; and this Section specifically provides that, in computing net capital, the value of the exchange seat and any other fixed assets may not be included.

Later, when the Act was amended to provide definitive standards for the regulation of brokers and dealers who effected transactions in the over-the-counter market rather than on an exchange, the Congress authorized the Commission by Section 15(c)(3) to prescribe rules "as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility of brokers and dealers."

When it came to adopting a rule, the Commission was urged to impose a fixed minimum net capital, such as is imposed by some states. However, it found that even if the minimum were quite low, a very substantial number of brokers and dealers would be put out of business.

Instead, the Commission promulgated its Rule X-15C3-1 (17 C.F.R. 240.15c3-1) which embodied the statutory ratio of twenty to one above referred to, but specified in greater detail what items could be included in computing net capital.

In the language of the rule, a broker may not permit his "aggregate indebtedness" to all persons to exceed 2000 per centum of his "net capital." These terms are words of art designed to secure a fair but effective liquid asset condition. In general, under the rule, the computation of "net capital" involves the listing of all assets and liabilities to determine net *worth*, and then deducting from net worth the value of assets not readily convertible into cash (such as buildings or unsecured loans) and specified percentages of other assets whose market value is subject to fluctuation to provide a cushion against fluctuation. "Aggregate indebtedness" comprises the total liabilities less certain forms of indebtedness, such as (1) those adequately collateralized by certain assets, or (2)

loans which are subject to agreements meeting the conditions of the rule which subordinate such loans to the claims of other general creditors.

It is obvious, of course, that adherence to the net capital requirements, like the provisions regulating banks and other institutions which handle other people's money, is of the utmost importance if investors are to deal with securities brokers with confidence and safety. As we shall show *infra* petitioner repeatedly disregarded these requirements. That his creditors ultimately were fortunate enough to be paid is no excuse for his willful violations of the rule. Moreover, we earnestly urge the Court to repudiate the suggestion of petitioner that the violations are mere technicalities. We feel certain that the Court will appreciate that these requirements go to the very heart of the public interest and the protection of investors.

FACTS

Petitioner's registration as a broker and dealer became effective on February 24, 1955.

Early in December 1955 one of the Commission's inspectors, in the course of the Commission's periodic examinations of registered broker-dealers, made an analysis of petitioner's books as of November 30, 1955, and found a deficiency in his net capital in the sum of \$220,545 (R. 194-9). The inspector orally called this deficiency to his attention on December 6, 1955 (R. 199). On December 14, 1955, petitioner was again orally notified that he was in violation of the rule (R. 201). On December 21, 1955, the inspector met with petitioner's then attorney and discussed petitioner's financial situation with him (R. 202).

Petitioner did not avail himself of these three opportunities to achieve compliance, for despite the admonitions of the Commission's staff his net capital remained insufficient to meet the minimum requirements set by the rule. A second analysis, made as of December 31, 1955, revealed that instead of correcting the situation petitioner had allowed it to become worse. This analysis disclosed a deficiency of \$226,657 (R. 203). Members of the staff

conferred with him, his attorney and his accountant on January 6, 1956 (R. 204), and on January 10, 1956 (R. 204), again calling to his attention his failure to maintain the minimum standards with respect to his capital requirements and affording him additional opportunities to achieve compliance. Despite these repeated warnings, it was not until January 18, 1956, on which date petitioner corrected a short position in one security, that he made any attempt to ameliorate the situation (R. 206). However, he was still far short of achieving compliance. This was due to the fact that \$46,500 of borrowed funds was treated by petitioner not as a liability but as capital, despite the fact that no subordination agreements had been obtained with respect to these funds (R. 207).¹ Subsequently, petitioner submitted subordination agreements but these did not meet the requirements of the rule and petitioner was so notified (R. 208).²

On April 3, 1956, April 9, 1956, May 17, 1956 and May 21, 1956, members of the Commission's staff orally conferred with petitioner's representatives, and notified them of petitioner's continuing deficiency (R. 173-4).

An analysis of petitioner's books as of May 31, 1956, disclosed a deficiency in his net capital in the sum of approximately \$54,000 (R. 211) which fact was called to petitioner's attention by the inspector (R. 214, 216) and further opportunities for compliance thus afforded. At this time, nearly four and one-half months after petitioner had been notified that the subordination agreements were unsatisfactory, he had not yet furnished the Commission with subordination agreements that complied with the

¹ The rule permits loans to be deducted from "aggregate indebtedness" if the particular creditors execute agreements meeting the conditions of the rule which subordinate their loans to those of general creditors.

² Any subordination agreement which is cancellable at will is obviously no protection to customers. The rule, therefore, defines a satisfactory subordination agreement as one which, among other things, is not subject to cancellation for at least one year. The agreements submitted by petitioner did not include such restriction.

provisions of the rule (R. 212). It should be emphasized that the deficiencies were not due entirely to the absence of the agreements. There was still a substantial deficiency in his net capital even after excluding from aggregate indebtedness the loans covered by the unsatisfactory subordination agreements (R. 211-214).

Petitioner furnished further evidence of his disregard for the Commission's rules when it was determined on June 15, 1956, that petitioner still had not obtained satisfactory subordination agreements and consequently failed to meet the minimum standards for investor protection in that his net capital was still deficient (R. 217). Again, the staff notified petitioner of this deficiency and afforded him an additional opportunity to comply with the Commission's rules (R. 216). It was not until July 19, 1956 that petitioner obtained proper subordination agreements. At no time in these eight months had petitioner ever denied that he was in violation of the rule.

However, all of these efforts on the part of the staff in obtaining compliance by petitioner and the extreme leniency and indulgence afforded him had at most only an ephemeral effect, for a month later petitioner was again in violation of the Commission's rule. An analysis of petitioner's books on August 23, 1956, revealed that as of August 22, 1956, petitioner's net capital was again deficient in the sum of \$71,820 (R. 19).

Since it was now apparent that petitioner did not intend to comply voluntarily with the law, a complaint for a temporary restraining order and a preliminary and permanent injunction was filed by the Commission. On August 28, 1956, a temporary restraining order was issued against petitioner by the United States District Court for the Southern District of New York.³

Subsequently, at the hearing on the preliminary injunction, petitioner asserted that he was then in compliance with the law. However, the only thing his books re-

³ *S.E.C. v. M. J. Shuck*, S.D. New York, Civil Action No. 112-267 (1956).

vealed was a new credit of some \$40,000 with no details to indicate its source (R. 76). Petitioner stated that \$20,000 of that sum represented a sale of income on certain oil properties (R. 77) but his books had never reflected any ownership of oil properties (R. 78). He claimed that the other \$20,000 was merely money he had accumulated over a period of time without disclosing where it came from (R. 79). If, of course, as the staff suspected, this \$40,000 was borrowed, then instead of correcting the deficiency, it only increased the indebtedness. Petitioner and his counsel promised to supply documentary proof of their contentions (R. 109) but this was never done.

After considering petitioner's contentions, and after hearing argument and receiving legal memoranda from counsel, the District Court, on September 6, 1956, issued a memorandum opinion which found that a preliminary injunction should be granted and in which the Court stated:

"The defendant does not deny the facts charged by the Commission which constitute the violation sought to be restrained. The defendant merely contends he was too speedily haled to court and urges that he will in the future comply with the Commission's rules. The contention is not supported by the admitted facts and I am not persuaded that the promise of future compliance is buttressed by his past record. It appears from the Commission's affidavits that the condition complained of was first pointed out to the defendant almost a year ago."

On September 7, 1956, the Court issued a preliminary injunction against petitioner, including in its order the following finding:

". . . the defendant, M. J. Shuck, individually, and doing business as M. J. Shuck Co., was engaged in and about to engage in acts and practices which constitute a violation of Section 15(c)(3) of the Securities Exchange Act of 1934, 15 U.S.C. 78o(c)(3) and . . . unless enjoined, will continue to engage in said acts and practices. . . ."

On October 24, 1956, petitioner filed with the Commission a notice of withdrawal of his registration. Such withdrawal does not become effective if within 30 days the Commission institutes a proceeding to revoke or suspend the registration. The Commission instituted such a proceeding by its order dated November 16, 1956.

The order for proceedings and notice of hearing alleges that petitioner is temporarily enjoined by the United States District Court from engaging in and continuing certain conduct and practices in connection with the purchase and sale of securities and that petitioner used the mails and the means and instrumentalities of interstate commerce to effect securities transactions while in violation of Section 15(c)(3) of the Securities Exchange Act of 1934 and Rule X-15C3-1 thereunder.

The order directed that a hearing be held for the purpose of taking evidence on the matters set forth above, which hearing was held on January 14 and 15, 1957, before a hearing examiner.

The hearing examiner filed a recommended decision on May 7, 1957, in which he recommended that petitioner's registration be revoked and that petitioner be expelled from the National Association of Securities Dealers, Inc. Petitioner filed exceptions to the recommended decision and these were argued orally before the Commission on July 10, 1957. The Commission filed its findings, opinion and order on September 13, 1957, revoking petitioner's registration (R. 341-350). It held that the existence of the injunction furnished the statutory basis for revocation so that it was not necessary to make any additional finding of violations (R. 345). It also considered the whole record and determined that it was in the public interest to revoke petitioner's registration (R. 346-348). It held that the history of petitioner's repeated violations in the face of numerous warnings given him, clearly brings the situation within the express exception provided in Section 9(b) of the Administrative Procedure Act with respect to cases of willfulness or those involving the public interest (R. 348), particularly since the revo-

cation rests on the statutory basis of the injunction (R. 348 fn. 5).

This petition is for review of that order.

SUMMARY OF ARGUMENT

Petitioner's registration as a broker-dealer was revoked on the statutory basis of an injunction issued by a United States District Court pursuant to Section 15(b) of the Securities Exchange Act of 1934 which authorizes such revocation if a broker-dealer is permanently or temporarily enjoined. Petitioner, in this proceeding, may not collaterally attack that injunction or add a condition to the statute that such injunction be disregarded unless issued after a full hearing on the merits. However, this injunction was issued after such full hearing.

The statement of facts amply justifies the finding that revocation was in the public interest. Petitioner's repeated violations in the face of numerous admonitions and warnings leave no other conclusion. All of these facts are in the record, although in determining the question of public interest, as distinguished from the basic ground of revocation, this Court has held that the Commission is not limited to record evidence.

Section 9(b) of the Administrative Procedure Act, which requires written notice of violation and an opportunity to achieve compliance, is intended to provide only for inadvertent or unintentional violations. The section specifically makes such requirement inapplicable in cases of willfulness and those relating to the public interest. Petitioner's flagrant disregard of the law over a period of nine months despite numerous admitted warnings and admonitions clearly brings this case within those exceptions. This Court has previously considered the term "willfulness" within the meaning of this section and the facts herein fully meet this Court's definition.

ARGUMENT

- I. That petitioner was enjoined by a court of competent jurisdiction from violations of the Securities Exchange Act is a basis for revocation of petitioner's registration.

Section 15(b) of the Securities Exchange Act, 15 U.S.C. § 78o(b), provides that the Commission, after appropriate notice and opportunity for hearing, shall revoke the registration of any broker or dealer if it finds that such revocation is in the public interest and that such broker or dealer

- (1) has willfully made a false filing in connection with an application for registration; or
- (2) has been convicted within ten years of a misdemeanor or felony involving a securities transaction; or
- (3) is permanently or temporarily enjoined by a court of competent jurisdiction from engaging in or continuing to engage in any conduct or practice in connection with the purchase or sale of any security; or
- (4) has willfully violated any provision of the Securities Act of 1933 or the Securities Exchange Act of 1934.

The first two of the bases for revocation set out in Section 15(b) are not involved in this case. Furthermore, the Commission expressly stated in its opinion and order revoking petitioner's registration that it was unnecessary to consider the fourth basis, i.e., whether petitioner violated the Acts, since the third one, namely the existence of an injunction against petitioner, itself furnishes a statutory ground for revocation (R. 345).

Except for the general question of public interest, which we discuss in Point II, it seems to us that the existence of the injunction effectively disposes of the entire case.

Petitioner urges this Court, in effect, to amend the statute. Notwithstanding that Congress expressly stated that either a *temporary* or a permanent injunction may

serve as a basis for revocation, petitioner asks this Court to delete the portion relating to temporary injunctions.

Moreover, petitioner asks this Court to further amend the statute by requiring that the injunction be disregarded unless it results from a full-scale hearing on the merits. Of course, there is no such requirement in the statute, and to introduce such a requirement would effectively deprive the Commission of the power to revoke a registration on the basis of even a permanent injunction entered by consent or by default.

Assuming, *arguendo*, that only an injunction resulting from a determination on the merits could serve as a statutory basis for revocation, the injunction issued by the District Court would meet those requirements. The memorandum opinion of Judge McGohey (R. 276) states that the Commission moved, by order to show cause, for a preliminary injunction, that argument on the motion was heard on September 4, 1956, and that counsel for defendant (petitioner) was granted until September 5, 1956, to file his memorandum. The opinion further states (R. 276) that:

"The defendant does not deny the facts charged by the Commission which constitute the violation sought to be restrained. The defendant merely contends that he was too speedily hailed into court and urges that he will in the future comply with the Commission's rules. The contention is not supported by the admitted facts and I am not persuaded that the promise of future compliance is buttressed by his past record."

On September 7, 1956 the Court issued a preliminary injunction against petitioner, including in its order the following finding (R. 250):

". . . the defendant, M. J. Shuck, individually, and doing business at M. J. Shuck, Co., was engaged in and about to engage in acts and practices which constitute a violation of Section 15(c)(3) of the Securities Exchange Act of 1934, 15 U.S.C. 78o(c)(3) and . . . unless enjoined, will continue to engage in said acts and practices . . ."

Whether the District Court for the Southern District of New York erred in its decision and in its findings is not a question that can be collaterally attacked either before the Commission or in this Court. If petitioner believed that the injunction was improperly entered, his remedy was an appeal to the Court of Appeals for the Second Circuit. Petitioner should well know that review of the District Court's decision cannot be had before an administrative agency. Nor can the questions presented in the injunctive action be relitigated before this Court.

These arguments that the petitioner is advancing serve only to detract attention from the simple reality, namely, that an injunction has been issued by a court of competent jurisdiction. The only issue is whether it is in the public interest to revoke petitioner's registration.

We now turn to the question of "public interest."

II. There was substantial evidence on which the Commission could find that it was in the public interest to revoke petitioner's registration.

Although, as we have shown above, the injunction itself affords a basis for revocation, such action is not automatically mandatory. The Commission need not revoke unless it finds that such action is in the public interest.

The Commission carefully considered the question of public interest and examined the history of petitioner's activities. These are detailed, *supra*, in our counter-statement of the case and in the Commission's opinion (R. 346-348). The Commission concluded that petitioner's violations for almost a year prior to the injunction in the face of numerous warnings "demonstrate at the least a lack of any real concern about the matter, and negative any conclusion that the . . . deficiency . . . was unintentional or inadvertent" (R. 347-348). The Commission also noted that the District Court's Opinion and Order clearly indicate that the Court was of the opinion that petitioner would continue to violate the law in the future unless enjoined (R. 348).

The Commission concluded that "under all the circumstances" it was in the public interest to revoke petitioner's registration.

Petitioner appears to argue that the Commission may not consider violations which occurred prior to July 1956 (Br. 17-18) in determining the issue of willfulness or public interest. Petitioner would like to eliminate from consideration every violation but one, coupled with his bare assertion that that violation was corrected. Apart from the fact that he never did establish that this particular violation was corrected, we are at a loss to understand upon what principles of reason or logic he asks this Court, as he did the Commission, to close its eyes to all the other undisputed and long uncorrected violations in determining what remedial action is necessary in the public interest.

Perhaps petitioner is confusing the consideration of public interest with that of the basic findings of violation. Had the Commission revoked on the basis of its own findings of violation, there might, perhaps, be some color to an argument that the Commission should not revoke on the basis of violations not alleged in the order for hearing. Although we do not concede such a contention to be valid, it would serve no purpose to discuss it here. For, as we must reiterate, the revocation here rested on the statutory basis of the existence of an injunction.

In considering the question of public interest as distinguished from the basic ground of revocation, the Commission may inquire into any matters which will aid in its determination. Indeed, this Court has even rejected the argument that the Commission is confined to the record in considering such matters. In *R. H. Johnson & Co. v. S.E.C.*, the Commission, in determining the question of public interest, had considered prior disciplinary actions taken against Johnson by the New York Stock Exchange and the National Association of Securities Dealers, evidence of which had not been introduced in the record. Johnson's objection to the consideration of such matters (See Johnson Brief, pp. 58-59) was rejected by

this Court in a Per Curiam decision without discussion, 97 App.D.C. 364, 231 F. 2d 523 (1956).⁴ In the instant case, the Commission did not go outside the record. The evidence in the record abundantly demonstrated petitioner's complete indifference to his obligations.⁵

We submit that the record amply justifies the Commission's finding that revocation was in the public interest.

III. The Commission fully complied with the letter and spirit of the Administrative Procedure Act.

The Commission has long recognized, even before the passage of the Administrative Procedure Act, that the basic principles of fair play require that if one has inadvertently or unintentionally violated a statute or rule, administrative action should not be taken against him before he is given an opportunity to comply. This concept accounts for the provisions for notice of violation and opportunity to correct as found in Section 9(b) of the Administrative Procedure Act. But these principles have no application in any situation where the violations are knowing and intentional. The statute recognizes this fact by making such notice unnecessary in cases of willfulness.

The Commission's findings are succinctly stated in its opinion (R. 347-348) as follows:

"Registrant's actions for the period of almost a year before the entry of the injunction, during which he was informed numerous times of the requirements of and the need to comply with the net capital rule, demonstrate at least a lack of any real concern about the matter, and negative any conclusion that the

⁴ Johnson's petition for certiorari to the Supreme Court rested exclusively on this ground. Certiorari was denied, 352 U.S. 844.

⁵ Even in criminal cases the strict rules of evidence are limited to the primary question of guilt. Courts have a wide discretion in using out-of-court sources of information to assist them in determining the sanction to be imposed including criminal records, affidavits, reports by probation officers, etc. *Williams v. New York*, 337 U.S. 241, 246-7.

August 22, 1956 deficiency in required net capital was unintentional or inadvertent."

The history of petitioner's violations, as set out above in our counterstatement of the case and in the Commission's opinion, standing alone, would be sufficient to convince even the most charitably inclined of petitioner's disregard for the Commission's rules. Petitioner admits that he was repeatedly advised orally of the violations (Br. 4, 16, 17). In the face of these repeated warnings, petitioner failed to achieve compliance over a period of several months. Such lassitude does not bespeak concern for compliance with the Commission's regulations.

This Court has already determined the meaning of "willfulness" in the section in question. In *Air Transport Associates v. CAB*, 91 App.D.C. 147, 199 F. 2d 181, 186 (1952), in considering the meaning of willfulness under Section 9(b) of the Administrative Procedure Act, this Court cited *Hughes v. SEC*, 85 App.D.C. 56, 174 F. 2d 969, 977 (1949) in which this Court said:

"It is only in very few criminal cases that 'willful means 'done with a bad purpose.' Generally, it means 'no more than that the person charged with the duty knows what he is doing. It does not mean that, in addition, he must suppose that he is breaking the law.'"⁶

In the instant case, petitioner not only knew what he was doing, but also knew that he was "breaking the law."

If the Court agrees with us that the facts here constitute willfulness, thus making inapplicable the notice requirement of Section 9(b), it is unnecessary to go any further. Furthermore, the instant situation falls within the "public interest" exception of that section. For the notice requirement of Section 9(b) to have any significance, it must mean that no order of revocation or other disciplinary action will be taken if compliance with the

⁶ See also *New England Air Express, Inc. v. CAB*, 90 App.D.C. 215, 194 F. 2d 894 (1952); *Great Western Food Distributors, Inc. v. Brannan*, 201 F. 2d 476 (C.A. 7, 1953).

statute is achieved. By the same token, if the alleged violation is so flagrant or so fraught with danger to the public that the "public interest" requires revocation, no formal notice of the propose issuance of the order should be required under Section 9(b).

We believe, therefore, that the public interest exception under Section 9(b) of the Administrative Procedure Act necessarily includes any conduct which is serious enough to warrant revocation in the public interest under Section 15(b) of the Securities Exchange Act, and accordingly, the term "public interest" in the Administrative Procedure Act should not be interpreted more narrowly than in the Exchange Act.

It may further be noted that Section 15(b) of the Securities Exchange Act by its terms permits revocation of a broker-dealer's registration only in the kinds of cases which would come within the exceptions provided in Section 9(b) of the Administrative Procedure Act. Thus, Section 15(b) specifically requires a finding that revocation is in the public interest as a prerequisite to any order of revocation. In addition, each of the four bases for revocation under Section 15(b) involves the element of willfulness. The first and fourth bases explicitly require a willful violation of the Act or a willful false filing. The second and third bases, namely, the conviction of a crime or the entry of an injunction, necessarily involve the element of willfulness.

Moreover, we do not see how the notice requirement can have any applicability when the revocation under Section 15(b) of the Exchange Act is based upon a conviction or an injunction. If a broker-dealer, for instance, has been convicted of embezzling funds of his customers, must the Commission, before instituting a proceeding to revoke his registration, send him a written notice and give him an opportunity to achieve compliance by seeking a Presidential pardon?

Similarly, in the instant case, a United States District Court has issued an injunction after finding willful continued violations and being of the opinion that violations

would continue unless enjoined. The statute authorizes revocation based on such injunction if necessary in the public interest. Just what purpose could be served by sending a further written notice, or how the violator could comply, we do not understand.

We submit, therefore, that the Commission has fully complied with all the requirements of the Administrative Procedure Act. Indeed, so far as the spirit of Section 9(b) is concerned, we think the indulgence granted petitioner far exceeds anything ever contemplated by the Act.

CONCLUSION

The order of the Commission should be affirmed.

Respectfully submitted,

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